



## **SPECIAL MEETING OF THE RENT BOARD OF THE CITY OF RICHMOND**

CITY COUNCIL CHAMBERS, COMMUNITY SERVICES BUILDING  
440 Civic Center Plaza, Richmond, CA 94804

**Wednesday, February 28, 2018**

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### **Boardmembers**

Nancy Combs  
Virginia Finlay  
Emma Gerould  
David Gray  
Lauren Maddock

***Link to Rent Board Meeting Agendas and Accompanying Materials:***

[www.ci.richmond.ca.us/3375/Rent-Board](http://www.ci.richmond.ca.us/3375/Rent-Board)

### **COMMUNICATION ACCESS INFORMATION**

This meeting is being held in a wheelchair accessible location. To request disability-related accommodation(s) to participate in the meeting, including auxiliary aids or services, please contact Bruce Soublet, ADA Coordinator, at (510) 620-6509 at least three business days before the meeting date.

### **NOTICE TO PUBLIC**

The City of Richmond encourages community participation at public meetings and has established procedures that are intended to accommodate public input in a timely and time-sensitive way. As a courtesy to all members of the public who wish to participate in Rent Board meetings, please observe the following procedures:

**Public Comment on Agenda Items:** Persons wishing to speak on a particular item on the agenda shall file a speaker form with City staff **PRIOR** to the Rent Board's consideration of the item on the agenda. Once the clerk announces the item, only those persons who

have previously submitted speaker forms shall be permitted to speak on the item. Each speaker will be allowed up to two minutes to address the Rent Board.

Public Forum: Individuals who would like to address the Rent Board on matters not listed on the agenda or on items remaining on the consent calendar may do so under Public Forum. All speakers must complete and file a speaker's card with City staff prior to the commencement of Public Forum. The amount of time allotted to individual speakers shall be determined based on the number of persons requesting to speak during this item. The time allocation for each speaker will be as follows: 15 or fewer speakers, a maximum of 2 minutes; 16 to 24 speakers, a maximum of 1 and one-half minutes; and 25 or more speakers, a maximum of 1 minute.

Conduct at Meetings: Richmond Rent Board meetings are limited public forums during which the City strives to provide an open, safe atmosphere and promote robust public debate. Members of the public, however, must comply with state law, as well as the City's laws and procedures and may not actually disrupt the orderly conduct of these meetings. The public, for example, may not shout or use amplifying devices, must submit comment cards and speak during their allotted time in order to provide public comment, may not create a physical disturbance, may not speak on matters unrelated to issues within the jurisdiction of the Rent Board or the agenda item at hand, and may not cause immediate threats to public safety.

City Harassment Policy: The City invites public comment and critique about its operations, including comment about the performance of its public officials and employees, at the public meetings of the City Council and boards and commissions. However, discriminatory or harassing comments about or in the presence of City employees, even comments by third parties, may create a hostile work environment, if severe or pervasive. The City prohibits harassment against an applicant, employee, or contractor on the basis of race, religious creed, color, national origin, ancestry, physical disability, medical condition, mental disability, marital status, sex (including pregnancy, childbirth, and related medical conditions), sexual orientation, gender identity, age or veteran status, or any other characteristic protected by federal, state or local law. In order to acknowledge the public's right to comment on City operations at public meetings, which could include comments that violate the City's harassment policy if such comments do not cause an actual disruption under the Council Rules and Procedures, while taking reasonable steps to protect City employees from discrimination and harassment, City Boards and Commissions shall adhere to the following procedures. If any person makes a harassing remark at a public meeting that violates the above City policy prohibiting harassment, the presiding officer of the meeting may, at the conclusion of the speaker's remarks and allotted time: (a) remind the public that the City's Policy Regarding Harassment of its Employees is contained in the written posted agenda; and (b) state that comments in violation of City policy are not condoned by the City and will play no role in City decisions. If any person makes a harassing remark at a public meeting that violates the above City policy, any City employee in the room who is offended by remarks violating the City's policy is excused from attendance at the meeting. No City employee is compelled to remain in attendance

where it appears likely that speakers will make further harassing comments. If an employee leaves a City meeting for this reason, the presiding officer may send a designee to notify any offended employee who has left the meeting when those comments are likely concluded so that the employee may return to the meeting. The presiding officer may remind an employee or any council or board or commission member that he or she may leave the meeting if a remark violating the City's harassment policy is made.

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## SPECIAL MEETING OF THE RICHMOND RENT BOARD

### AGENDA

6:00 PM

**A. PLEDGE TO THE FLAG**

**B. ROLL CALL**

**C. STATEMENT OF CONFLICT OF INTEREST**

**D. AGENDA REVIEW**

**E. PUBLIC FORUM**

**F. RENT BOARD CONSENT CALENDAR**

- F-1.** APPROVE the minutes of the February 21, 2018 Regular Meeting of the Richmond Rent Board. *Cynthia Shaw*
- F-2.** RECEIVE letters from community members regarding the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance, RMC 11.100. *Cynthia Shaw*
- F-3** APPROVE a sole source contract amendment with Kenneth Baar in the amount of \$20,001 for the preparation of rent adjustment regulations for consideration by the Rent Board, for a total contact amount not to exceed \$30,000. ***THIS ITEM WAS CONTINUED FROM THE FEBRUARY 21, 2018 MEETING.*** *Nicolas Traylor*

**G. STUDY AND ACTION SESSION**

- G-1.** RECEIVE a presentation concerning application of the proposed draft Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9) and PROVIDE direction to staff. *Nicolas Traylor*  
*Michael Roush*

**H. RENT BOARD AS A WHOLE**

- H-1.** RECEIVE a proposed timeline for (1) adoption of the Fiscal Year 2018-19 Rent Program Budget; (2) recommendation of approval of the FY 2018-19 Rental Housing Fee to the City Council; and (3) billing of the FY 2018-19 Residential Rental Housing Fee. *Nicolas Traylor*

**I. REPORTS OF OFFICERS**

**J. ADJOURNMENT**

***Any documents produced by the City and distributed to a majority of the Rent Board regarding any item on this agenda will be made available at the Rent Program Office located on the second floor of 440 Civic Center Plaza and will be posted at [www.richmondrent.org](http://www.richmondrent.org).***

# AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: February 28, 2018

Final Decision Date Deadline: February 28, 2018

**STATEMENT OF THE ISSUE:** The minutes of the February 21, 2018, Regular Meeting of the Richmond Rent Board require approval.

## 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

- |   |  |  |
|---|--|--|
| <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:** APPROVE the minutes of the February 21, 2018 Regular Meeting – Rent Program (Cynthia Shaw 620-5552).

AGENDA ITEM NO:

**F-1.**

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**RICHMOND, CALIFORNIA, February 21, 2018**

The Regular Meeting of the Richmond Rent Board was called to order at 5:01 P.M.

**PLEDGE TO THE FLAG**

**ROLL CALL**

**Present:** Boardmembers Combs, Finlay, Maddock, Vice Chair Gerould and Chair Gray

**Absent:** None.

**STATEMENT OF CONFLICT OF INTEREST**

None.

**AGENDA REVIEW**

Item F-3 was pulled by staff from the consent calendar to be discussed at the next Board meeting.

**PUBLIC FORUM**

Cordell Hindler invited the Board to community events including the International Women's Day Celebration in March.

Lori Wickliff spoke on the behalf landlords, commending the Board for allowing landlords to give ideas and comments on the proposed Regulations. She also requested that landlords be given more time to review and comment on the proposed Regulations since the material is difficult to understand. When approved, she would like the Regulations to be easy to understand for the benefit both landlords and tenants. She also requested that some language from Berkeley Regulations be added in regards to the sub-tenant paying the landlord more rent.

Levy Ephraim spoke requesting more time to review and comment on the proposed Regulations, since they are not clear and easy to understand. He also mentioned that the rents for his building are historically low and that he has made capital improvements.

Marilyn Langlois spoke on the behalf of the Fair and Affordable Richmond Coalition and complimented staff on the hard work with the Regulations. She also spoke on the upcoming meeting item in regards to the Capital Improvement Regulations. She requests that the Regulation include language regarding not granting an increase for aesthetics or adding services or space that it would not be used as a basis for an increase and that the tenant must approve and agree to a rent increase. She also would like the language to include “necessary repairs” in regards to safety codes and no increases for routine maintenance.

Linda Newton spoke regarding the ordinance and the importance of balancing the interest of tenants and landlords and providing community stability. She expressed concerns about findings (d) and (e) of the Ordinance, particularly because most landlords in Richmond do not own apartment buildings with 50 units or more.

Sherry Zalabak spoke regarding Capital Improvements she made to her property and asked how can she recoup some of the money paid for the improvements?

### **RENT BOARD CONSENT CALENDAR**

On motion of Vice Chair Gerould, seconded by Boardmember Combs, the item(s) marked with an (\*) were approved by the unanimous vote of the Rent Board, with Item F-3 to be continued to February 28, 2018 meeting.

\*F-1. Approve the minutes of the January 24, 2018, Special Meeting of the Richmond Rent Board.

\*F-2. Receive letters from community members regarding the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance, RMC 11.100.

F-3. Continued to February 28, 2018, Special Rent Board Meeting, approve a sole source contract amendment with Kenneth Baar in the amount of \$5,001 for the preparation of rent adjustment regulations for consideration by the Rent Board, for a total contract amount not to exceed \$15,000.

## **REGULATIONS**

G-1. The matter to adopt Substantive Rent Adjustment Regulations (Subchapter C: Standards for Individual Rent Ceiling Adjustments), Vacancy Rent Increase Regulations (Chapter 7) and Rent Registration Regulations (Chapter 4) was presented by Deputy Director, Paige Roosa. The presentation included information about the background, scope of proposed rent adjustment regulations, community engagement process, recommended modifications to proposed regulations chapters 4, 7 and 9, case study research of adopted rent increase standard for other rent controlled jurisdictions, additional suggested modifications, proposed timeline and next steps and the recommended action. Discussion ensued. The following individuals gave comments: Lori Wickliff, Fallon Scoggins, and Sherry Zalabak. A motion by Chair Gray, seconded by Vice Chair Gerould to adopt Regulations for Substantive Rent Adjustment Regulations (Subchapter C: Standards for Individual Rent Ceiling Adjustments), Vacancy Rent Increase Regulations (Chapter 7) and Rent Registration Regulations (Chapter 4), with the following amendments to Regulation 903, to include language similar to Berkeley Rent Boards Regulation in regards to the percentage amount granted to a landlord for an additional occupant through the petition process, passed by the following vote: **Ayes:** Boardmembers Combs, Finlay, Maddock, and Chair Gray. **Noes:** Boardmember Finlay voted No on Regulation 903 **Abstentions:** None. **Absent:** None.

## **STUDY AND ACTION SESSION**

H-1. The matter to receive the proposed draft Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9) was presented by Executive Director, Nicolas Traylor with assistance from Ken Barr who attended by conference call. The presentation included the purpose of developing a Fair Return Standard, a list of factors allowed for a fair return increase, general description of Maintenance of Net Operating (MNOI) Standard, how MNOI standards and resulting rent increases would work over time, the proposed MNOI standard, selecting a base year for MNOI calculation, what happens when there is no base year operating income data?, using inflation to adjust base year net operating income to provide a fair return, an illustration of MNOI standard alternative “indexing” ratios, allowance for amortized cost of capital improvements, the important facts about the interest allowance for amortized costs, adjustments of exceptional expense levels, projection of operating expenses in the absence of actual

data, ceilings on amount of rent increases within a year, a comparison of fair return rent increase limits by city, allowing landlords to account for legal cost in a fair return petition, and policy alternatives to be addressed in subsequent memos. Discussion ensued. There were no public comments on this item. No action was taken. The Board received the proposed draft Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9).

### **REPORTS OF OFFICERS**

Executive Director, Nicolas Traylor, gave a brief report on the Tenant in Richmond 101 Community Workshop that was held on February 17th and that staff will begin presenting on budget proposals in March and April that will include a fee study for the upcoming registration year fees for fully covered and partially covered units. Deputy Director, Paige Roosa, added that staff has been working with the Planning and Building Services Department and the Housing Authority as it relates to more targeted outreach to tenants in subsidized housing units.

### **ADJOURNMENT**

There being no further business, the meeting adjourned at 8:38 P.M.

Cynthia Shaw and Andrea Zuniga  
Staff Clerks

(SEAL)

Approved:

David Gray, Chair

# AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: February 28, 2018

Final Decision Date Deadline: February 28, 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"/> 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.**

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Stephen D. Pahl	Sonia S. Shah
Karen K. McCay	Helene A. Simvoulakis-Panos
Fenn C. Horton	John A. List
Catherine S. Robertson	Eric J. Stephenson
Servando R. Sandoval	Lerna Kazazic
Ginger L. Sotelo	-----
Theresa C. Becerra	Sarahann Shapiro
	<i>Special Counsel</i>

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2530 Wilshire Blvd., Suite 200, Santa Monica, California 90403-4663 • Tel: 424-217-1830 • Fax: 424-217-1854

Reply to San Jose Office  
Sender's Direct Dial No.: (408) 918-2832  
Sender's Email Address: [kmccay@pahl-mccay.com](mailto:kmccay@pahl-mccay.com)

February 20, 2018

**Via Electronic Mail Only**

City of Richmond Rent Program  
Attention: Paige Roosa  
440 Civic Center Plaza, Suite 200  
Richmond, California 94804  
[paige\\_roosa@ci.richmond.ca.us](mailto:paige_roosa@ci.richmond.ca.us)

Re: Comments to DRAFT Rent Adjustment Regulations: *Chapter 4 (Rent Registration), Chapter 7 (Vacancy Rent Increases) and Chapter 8 – Subchapter C (Standards for Individual Rent Ceilings Adjustments)*

Dear Richmond Rent Board Members:

On behalf of the Bella Vista at Hilltop Apartment Community, which offers 1008 apartments for rent in the City of Richmond, all of which are subject to The Richmond Fair Rent, Just Cause for Eviction and Homeowner Protection Ordinance (“Ordinance”), we bring to the Board’s attention the following grounds for opposing the proposed Rent Adjustment Regulations: *Chapter 4 (Rent Registration), Chapter 7 (vacancy Rent Increases) and Chapter 8 – Subchapter C – Standards for Individual Rent Ceilings Adjustments* (“Proposed Regulations”) released for public comment to be received no later than 5:00 p.m. on Tuesday, February 20, 2018. As set forth in more detail below, the Proposed Regulations as drafted:

1. Are preempted by California Civil Code Section 1954.53(a)(1) and California Civil Code Section 827, in that they impermissibly expand the statutory exception to an owner’s right to establish the initial rental rate for a unit;
2. Are preempted by California Evidence Code Section 500, by improperly shifting the burden of proof of a voluntary vacancy to the landlord;
3. Create an insurmountable hurdle in the registration process by requiring a landlord to identify the “services” included in rent where “services” are so broadly defined by the Ordinance; and



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4. Fail to address tenant-created code violations, habitability concerns or other reductions or deteriorations in the condition of the unit when considering downward adjustments in individual rent.

While there are other concerns with respect to the proposed regulations, we urge the Board to decline to adopt the Proposed Regulations unless and until the following legal and practical issues are addressed.

Proposed Regulations are Preempted by State Law

In 1995, the Costa-Hawkins Act (“Act” or “Costa-Hawkins”) was approved and signed into law. Cal. Civ. Code §§ 1954.50 – 1954.535. The Act is a general state law that governs a landlord’s ability to set the initial rent for his, her or its property, even in rent-controlled jurisdictions, with certain exceptions. One exception is where:

The previous tenancy has been terminated by the owner by notice pursuant to Section 1946.1 or has been terminated upon a change in terms of the tenancy noticed pursuant to Section 827, except a change permitted by law in the amount of rent or fees.

Cal. Civ. Code § 1954.53(a)(1) (emphasis added). California Civil Code Section 827 in turn provides that a:

. . . landlord may, upon giving notice in writing to the tenant . . . change the terms of the lease to take effect . . . at the expiration of not less than 30 days. . . .

The notice, when served upon the tenant, shall in and of itself operate and be effectual to create and establish, as part of the lease, the terms, rents, and conditions specified in the notice, if the tenant shall continue to hold the premises after the notice takes effect.

Cal. Civ. Code § 827(a) (emphasis added). As such, under Section 827, a landlord has the right to change the terms of a month-to-month tenancy, but, if the change is not acceptable to the tenant, he or she may choose to terminate their tenancy before the notice takes effect. If the tenant chooses to terminate before the notice takes effect, the tenancy will have terminated “upon a change in terms of tenancy.” If the tenant chooses not to terminate before the notice takes effect, then there is no termination upon a change in terms of tenancy under the Act.

“When attempting to ascertain the ordinary, usual meaning of a word, courts appropriately refer to the dictionary definition of that word.” Wasatch Property Management v. Degrade, 35 Cal. 4th 1111, 1121-22 (2005) (citing People v. Leal, 33 Cal. 4th 999, 1009 (2004)).



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Webster's dictionary defines "upon" as meaning, among other things, "*with little or no interval after.*" Webster's New International Dictionary (2d ed. 1950) p. 175 (emphasis added). The Proposed Regulations improperly attempt to extend the definition well beyond the ordinary and usual meaning of the word "upon." Proposed Regulation Section 702(A)(1)(b) provides, in pertinent part, that:

A tenancy shall be presumed to have terminated **upon** a change in terms of tenancy if the tenant(s) vacate(s) the rental unit **within twelve months** of the landlord's unilateral change in the terms of the rental agreement. Absent a showing by the landlord that the tenant(s) vacated for reasons other than the change in the terms of the rental agreement, the initial rental rate for the new tenancy shall be no greater than the most recent rent ceiling (prior to the new tenancy).

Prop. Reg. § Section 702(A)(1)(b) (emphasis added). No court would interpret "within twelve months," as being the same as "little or no interval after" the issuance of a Section 827 notice.

Section 827 notices are often used by owners to benefit the entire community in reaction to situations unanticipated when entering into the initial lease agreement. If there is an increase in criminal activity at or around a property, an owner may issue a Section 827 change in terms to implement or expand no loitering policies on the private property. Such policies can reduce gang activity and drug trafficking which may have developed at or around a community. If residents complain about a lack of visitor parking, owners may issue a Section 827 change in terms to prohibit residents from using visitor or guest parking for tenant vehicles, which conduct makes such spaces unavailable for actual visitors of tenants. Section 827 notices also are used to implement parking permit programs to ensure that only resident vehicles are parked on a property where parking for residents becomes a problem as a result of unauthorized vehicles being stored on a property. If the Proposed Regulations are adopted as written, owners will be discouraged from taking such proactive steps for the benefit of their residents since, in doing so, owners risk losing their ability to set the initial rate of a new tenancy occurring within a year after the issuance of the policy change initiated to benefit the community as a whole.

Section 827 notices are also used to implement changes necessary to comply with applicable law, such as when new local laws are passed. For example, when the City of Richmond required landlords to add a "smoke-free addendum" to their current month-to-month lease, such could only have been accomplished through a Section 827 notice of change in terms. Under the Proposed Regulations, any tenant who vacated within twelve months of issuance of the City-required smoke-free addendum would be presumed to have "terminated upon a change in terms of tenancy" depriving the owner of its statutory right to set the initial rent of the next tenancy. Such a result is preempted by Costa-Hawkins which creates a limited exception to an owner's right to set initial rents where the prior tenancy has been terminated **upon** a change in



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terms of tenancy noticed pursuant to Section 827. In order to comply with state law, the Proposed Regulations must be changed to limit the exception, as the Act does, to terminations occurring prior to the effective date of a notice issued pursuant to Section 827.

Improperly Shifts the Burden of Proof to Landlords

The Regulations are also preempted by Evidence Code Section 500 (“Section 500”), which states:

Except as otherwise provided by law, a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting.

In other words, Section 500 mandates that where a party is asserting a claim, he or she is responsible for proving the underlying facts necessary to establish said claim. The Proposed Regulations are in direct conflict with Section 500. As previously quoted, Proposed Regulation Section 702(A)(1)(b) provides, in pertinent part, that:

A tenancy shall be presumed to have terminated upon a change in terms of tenancy if the tenant(s) vacate(s) the rental unit within twelve months of the landlord’s unilateral change in the terms of the rental agreement. **Absent a showing by the landlord that the tenant(s) vacated for reasons other than the change in the terms of the rental agreement,** the initial rental rate for the new tenancy shall be no greater than the most recent rent ceiling (prior to the new tenancy).

Prop. Reg. § Section 702(A)(1)(b) (emphasis added). Costa-Hawkins gives owners the right to set the initial rental rate for a dwelling unit except in specified circumstances. If a tenant, the Board or the City contends a landlord has demanded or accepted a rent payment in excess of the Maximum Allowable Rent, the Ordinance gives the landlord the right to seek relief in court or, for tenants, through an administrative complaint process. *See, e.g.*, Ordinance §§ 11.100.060(e)(14), 11.100.100, 11.100.110. In any such action, under Evidence Code Section 500, the claiming party would have the burden of proving the landlord accepted a rent amount in excess of what was allowed by the Ordinance and the Board cannot legally shift that burden onto the landlord.

In considering the City of Oakland’s Just Cause for Eviction Ordinance, adopted as initiative Measure EE (the “Oakland Ordinance”), the California Court of Appeal, First District, determined that language similar to the foregoing quoted provision of the Proposed Regulations was preempted by Section 500. The Oakland Ordinance stated that “[w]here the owner of record recovers possession under this Subsection (9) [for an owner move-in eviction], and where



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continuous occupancy for the purpose of recovery is less than thirty-six (36) months, such recovery of the residential rental unit shall be a presumed violation of this Ordinance.” Rental Hous. Ass'n of N. Alameda Cty. v. City of Oakland, 171 Cal. App. 4th 741, 757 (2009) (*quoting* Oakland Ordinance, § 6.A(9)(a)). The Appellate Court noted that the quoted portion of the Oakland Ordinance would:

. . . arise only in a tenant’s post-eviction suit against a landlord. In such a suit, the tenant seeks damages based on the landlord’s violation of the [Oakland] Ordinance for the landlord’s failure to occupy the unit following eviction. The tenant must argue the eviction was a pretext and a showing that the landlord thus violated the [Oakland] Ordinance is an essential part of the tenant’s cause of action. The tenant therefore has the burden of proof under Evidence Code section 500 to show the landlord has violated the owner move-in cause for eviction allowed by Measure EE. Section 6.A(9)(a) impermissibly shifts that burden.

Rental Hous. Ass'n of N. Alameda Cty. v. City of Oakland, 171 Cal. App. 4th at 757. The burden shift in the Proposed Regulations is just as impermissible as the attempted burden shift in Oakland as they are both preempted by California Evidence Code Section 500.

Not only is the proposed burden shift preempted by state law, it is practically impossible for a landlord to prove why a tenant vacated as there is no legal requirement for a tenant to give their landlord a reason for terminating a tenancy and there is no way for a landlord to compel a vacating tenant to provide one. Bella Vista at Hilltop has 1008 rental units. In any given month, the community may receive between 29 and 55 notices of termination from residents. While the community asks for a reason, more often than not, none is provided. Although a resident may sometimes tell management staff when they are serving their notices of termination that they have decided to purchase a home or that their decision is job-related, they are moving closer to family, or looking for a larger (or smaller) home due to a change in household size in casual conversation, such statements would not be admissible in most proceedings and most written notices only provide the date of termination, not the reasoning behind it. While most landlords would like to have this information as it would assist in marketing efforts, anticipating turnover, and directing resources to help retain existing residents, they cannot compel tenants to tell them their reasons or provide admissible evidence regarding their decisions.

#### Rent Registration Requirements Impose Insurmountable Hurdles on Landlords

The Proposed Regulations also require landlords to provide information regarding a tenant’s reason for terminating in order to be “properly registered” under the Ordinance. Proposed Regulation Section 402(A)(1)(c), as currently drafted, requires a landlord to file with the board completed registration statements which include:



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The date the current tenancy began and, for all tenancies that began after July 21, 2015, *an explanation of the circumstances of the termination of the previous tenancy **sufficiently detailed** to demonstrate whether the unit qualifies for a vacancy increase or not*, as described in Chapter 7 Vacancy Rent Increases.

Prop. Reg. § 402(A)(1)(c) (emphasis added). As previously stated, neither the Ordinance nor the Proposed Regulations provide any mechanism for a landlord to obtain this information from vacating tenants and we would expect most tenant advocates would object to a landlord mandating disclosure of what many people would consider private information regarding their personal lives and living arrangements. People move for many, many reasons some of which can be very personal and private: divorce, domestic violence, loss of a job, death or incapacity of a loved one, immigration issues, etc. and often tenants are not willing to share such personal information with their landlord. For the Board to adopt regulations mandating owners to provide information which they cannot legally compel tenants to give in order to be “properly registered” and, therefore, entitled to implement the Annual Allowable Rent Adjustment and establish initial rental amounts is a clear violation of an owner’s due process rights.

The Proposed Regulations further require a landlord to include in the registration statement “the *services* included in the rent.” Prop. Reg. § 402(A)(1)(d) (emphasis added). This is virtually impossible given the definition of “Housing Services” in the Ordinance. The Ordinance defines “Housing Services” to include, but not be limited to:

. . . repairs, maintenance, painting, providing light, hot and cold water, elevator service, window shades and screens, storage, kitchen, bath and laundry facilities and privileges, janitor services, utilities that are paid by landlord, refuse removal, furnishings, telephone, parking, the right to have a specified number of occupants, **and any other benefit, privilege or facility connected with the use or occupancy** of any Rental Unit. **Housing Services to a Rental Unit shall include a proportionate part of services provided to common facilities of the building** in which the Rental Unit is contained.

Ordinance § 11.100.030(e) (emphasis added).

In order to comply with the Proposed Regulations requiring identification of the “services” included in the rent given how that term is defined by the Ordinance, the landlord would be required to list every element of every rental unit from each plumbing and mechanical system within the building to the floor, wall and window coverings, and each bathroom and kitchen fixture and interior amenity. Since different floor plans may have different amenities or features depending on when they were updated or what building they are in, this alone is an



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overwhelming burden for a landlord, but the registration statement requirements do not stop there. The definition would also mandate disclosure in the registration statement of existing staffing positions which serve residents or relate to the operation of the property since the definition of “services” includes maintenance and janitor services and presumably extends to courtesy patrol, concierge, and other resident services. But wait, there is still more. The Proposed Regulations would also require the landlord, for each unit, to identify the services provided to common facilities of the building. While most landlords highlight certain amenities in marketing and other materials and, while lengthy and time consuming, most can likely provide such information within a registration statement, given the broad definition of “services” in the Ordinance, they would also be required to identify mechanical systems such as boilers, fire suppression, sprinklers, etc.

The Ordinance already diverts significant resources from property operations with its filing requirements. Bella Vista at Hilltop staff spend between approximately one and three hours each day approximately uploading notices of termination of tenancy since they are required to file each and every three-day notice to pay rent or quit and notices to perform covenant or quit, regardless of whether such notices are acted up. This alone is an undue burden given its 1008 rental units especially since management staff has been advised by the City that no one at the City even looks at the notices or does anything with the information provided. In fact, the City often requests information from owners that owners have already provided to the City rather than wade through the avalanche of information provided. To now expand this administrative burden to register each individual unit with its specific features and all “services” as defined by the Ordinance creates an undue burden on housing providers especially given the significant consequences of failing to comply.

Not only will the failure to “properly register” possibly negate future rent increases, but failing to identify each and every “service” as defined in the Ordinance can be used against a landlord in a petition for individual rent ceiling adjustments. As written, Proposed Chapter 8 calculates individual rent ceiling adjustments based upon the “percentage of impairment of the tenant’s use and benefit from the unit.” Prop. Reg. § 874(B)(1) and (2). If a landlord fails to identify each and every benefit, privilege and facility associated with a rental unit, then the percentage calculations will not accurately reflect the percentage of impairment one “decrease” may cause. In fact, the calculation proposed in Proposed Regulation Section 874 is a double-edged sword for any landlord. The more benefits, privileges and facilities identified by the landlord, the smaller percentage of impairment any one “benefit, privilege or service” can be assigned; however, the more benefits, privileges and facilities identified, the more likely a petition will be filed for a decrease in housing services even if the “decrease” is relatively minor and associated with normal and reasonable property operations.

While we are hopeful it was not the author(s)’ intent to create such an insurmountable burden in drafting the registration statement disclosure requirements, the above are foreseeable



City of Richmond Rent Program  
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effects of the Proposed Regulations unless the requirement to identify “services included in the rent” is deleted from the registration statement requirements.

### Standards for Individual Rent Ceiling Adjustments Fail to Address Conduct of Tenants

The Proposed Regulations fail to give any consideration whatsoever for “decreases” caused by tenants or circumstances beyond the control of the landlord. In Proposed Regulation Section 874(B)(4)(C), a missing smoke detector is identified as an example of a code violation that poses a significant threat to the health or safety of tenants not only justifying a rent increase, but a penalty absent proof of correction. It is ironic that the Program would use this example in the Proposed Regulations considering the number one reason for missing or inoperable smoke detectors is tenant interference. A smoke detector goes off and a tenant, in an effort to stop the alarm from sounding, removes a battery or knocks it off of the ceiling or wall. Rather than report the incident to the landlord, the tenant leaves the smoke detector inoperable. Under the Proposed Regulations, such conduct would be grounds for decrease in rent as there is no discretion for the hearing officer to consider interference by the tenant or other intervening causes. In fact, throughout Chapter 8 of the Proposed Regulations, the City references Civil Code Section 1941.1 relating to untenable dwellings, but conspicuously absent from the Proposed Regulations is any reference to Civil Code Section 1941.2 which imposes affirmative obligations on tenants before there is any duty on a landlord to repair a dilapidation under Section 1941 or 1942. Failing to take into account tenant conduct when evaluating petitions for decreases, incentivizes tenants to create habitability issues in order to reduce their rent.

The Proposed Regulations also fail to take into account decreases in services, as that term is defined in the Ordinance, necessary for required maintenance of a dwelling unit or building. There should be no decrease in services found where a landlord undertakes to perform reasonably necessary repair and maintenance work on rental property, which has the effect of temporarily interfering with or preventing the tenant's full use of housing services. Such an exception is supported by applicable case law (Golden Gateway Ctr. v. San Francisco Residential Rent Stabilization & Arbitration Bd., 73 Cal. App. 4th 1204, 1213 (1999)) and should be incorporated into the Proposed Regulations. Similarly, there should be exceptions where the decrease in services is caused by circumstances beyond a landlord's control. While Proposed Regulation Section 702(A)(4) contemplates an exception from the voluntary vacancy exceptions for vacancies resulting from health, safety, fire or building code violations caused by disasters, nowhere else in the Proposed Regulations are third party interference or natural disasters taken into account. The Proposed Regulations, which grant arguably unconstitutional levels of discretion in the hearing officers, should at the very least identify such circumstances as factors to be considered when deciding whether a downward adjustment is authorized.



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Conclusion

On behalf of Bella Vista at Hilltop Apartment Community, one of the largest rental projects within the City of Richmond, we urge you to defer adoption of the Proposed Regulations until they can be amended to address the concerns set forth herein. While this Community remains committed to complying with the Ordinance and its implementing regulations, as currently drafted, the Proposed Regulations violate state law, impose insurmountable burdens and fail to take into account the affirmative obligations of tenants under California law to maintain their units. Thank you for your consideration.

Sincerely,

PAHL & McCAY  
A Professional Corporation

A handwritten signature in black ink that reads 'Karen K. McCay'.

Karen K. McCay

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February 20, 2018

**Via Electronic Mail Only**

City of Richmond Rent Program  
Attention: Paige Roosa  
440 Civic Center Plaza, Suite 200  
Richmond, California 94804  
[paige\\_roosa@ci.richmond.ca.us](mailto:paige_roosa@ci.richmond.ca.us)

Dear Richmond Rent Board Members:

The California Apartment Association (CAA) which represents owners and managers of rental housing submits this letter to comment on items before the Richmond Rent Board (Rent Board) at its February 21, 2018 meeting. CAA respectfully requests that this letter be included as part of the public record.

By way of background, CAA is a non-profit trade association representing the rental housing industry in California. Our members provide homes to millions of California residents and our Contra Costa Division represents CAA members in Contra Costa County. CAA is committed to working with the Rent Board to develop regulations that implement Measure L in a fair, straightforward, and balanced manner. To that end, this letter addresses several of the items before the Rent Board on February 21, 2018.

**ITEM F-3: SOLE SOURCE CONTRACT WITH DR. KEN BAAR**

The Rent Board staff hired Dr. Ken Baar to offer input, analysis, recommendations, and advice on the fair return standards. **CAA has concerns about the ability of Dr. Baar to be objective or at least not impart a strong bias against the rental housing industry.** A review of Dr. Baar's background raises serious questions about Dr. Baar's ability to approach this project objectively.

Listed below are three articles he has published on the issue of rent control all of which indicate views that help facilitate the climate for which rent control could be acceptable, offer advice to cities and tenant attorneys on the issue of developing or defending rent control, and establish guidance to develop rent control laws:

- He is listed as a co-author of the article "The Emergence of Second Generation Rent Controls" which is designed to, in part, "provide Legal Services attorneys with basic rent control information to aid them in the representation of their clients."
- He authored "The Last Stand of Economic Substantive Due Process-The Housing Emergency Requirement for Rent Control." In this article, Baar goes at length to demonstrate the conditions at which rent control could be deemed appropriate and appears to espouse temporary rent controls.
- He wrote the "Guidelines for Drafting Rent Control Laws." In this document, he goes at great length to outline how cities can draft ordinances and issues cities must consider when developing rent regulation laws.

Copies of these publications can be made available upon request. In reviewing these documents, it is CAA's opinion that while Dr. Baar does have an impressive academic

background and a resume that indicates experience working on rent control issues, he imparts a bias that is not favorable to rental property owners or housing providers.

**The Rent Board should, at a minimum, vet additional consultants for this analysis who might be perceived as more neutral or not have a strong bias favoring one side of the issue.** Measure L gives the Rent Board the power to hire its own consultants; a RFQ or RFP should be issued to identify the most qualified neutral party to develop the analysis on the important issues the Rent Board is tasked with addressing.

CAA appreciates your dedication to the City of Richmond and looks forward to working in partnership with you on these important issues to ensure an effective and fair implementation of Measure L.

#### **ITEM G-1: DRAFT RENT REGULATIONS**

In reviewing the draft regulations, CAA offers the following comments on specific sections of the draft that is before the Rent Board:

##### Regulation 702(A)(6)

This section states that a landlord may not establish the initial rental rate for a unit (i.e., vacancy de-control does not apply) when the prior tenancy ended as a result of “conduct by the landlord such that the vacancy is non-voluntary, except for just cause as provided under [Measure L].” While CAA in no way condones illegal or unethical behavior by landlords, CAA is concerned that this regulation oversteps the authority of the Rent Board to regulate the rental rate charged at initial occupancy. It is not clear what the Rent Board’s authority is to remove vacancy decontrol in this situation. The Costa-Hawkins Rental Housing Act states that vacancy decontrol applies unless a specific enumerated situation applies, such as a no-cause termination pursuant to Civil Code § 1946 or upon a change in terms. *See* Civil Code § 1954.53(a). In other words, state law does not have any provisions specifically requiring the vacancy to be voluntary in order for vacancy decontrol to apply. This regulation should be re-drafted to mirror the requirements and exclusions of the Costa Hawkins Rental Housing Act.

##### Regulation 703(C)(4)(e)

This section defines “abuse of the right of access” as provided for in Civil Code § 1954 as a form of “harassment” which can cause a vacancy to be considered involuntary, and thus not eligible for vacancy decontrol. In addition to the issue raised above, there is a technical issue with the wording of this provision. Namely, it’s not clear what it means to “abuse” the right of access. Does “abuse” mean non-compliance with Civil Code § 1954? If so, that should be clear in the regulation. If the standard for “abuse” is something short of violation of the law, that is problematic as it could end up penalizing a landlord for engaging in conduct that is perfectly legal. CAA recommends that this section be removed from the regulation. In the event the Rent Board can provide authority for the position that it can limit vacancy decontrol in situations where the Rent Board deems the vacancy to have been involuntary, then CAA requests that this section be revised to apply only in situations where the landlord has violated the law.

##### Regulation 707(B)

This section deals with the ability of the landlord to increase the rent by any amount allowed by Civil Code § 1954.50, et seq., if all the original occupants of the unit have vacated and only subtenants remain. This is a requirement of The Costa-Hawkins Rental Housing Act. *See* Civil Code § 1954.53(d)(2). However, this section states that it does not apply if the subtenants were “approved” by the landlord. This language is problematic because Measure L law requires the landlord to allow subtenants in various situations (*see* RMC 11.100.050(a)(2)(i) and (ii)). Thus, subtenants that the landlord would not have allowed but for the provisions of Measure L could be considered “approved,” thereby eliminating the landlord’s ability to increase the rent as otherwise allowed by state law.

This provision should be either removed or amended to address the situation in which the landlord allowed the subtenant only because the law required them to.

Regulation 874

The numbering convention of this section is confusing and inconsistent with the rest of the regulations. While the other regulations use a numbering convention which follows a capital letter > number > lower case format, this section uses a capital letter > number > capital letter again, which causes confusion. In addition, the numbered subdivisions of this section are followed by a period, whereas the numbered subdivisions of the other regulations use parenthesis. The numbering of this section should be corrected so as to be consistent with the rest of the regulations.

Regulation 874(A)(4)

This section requires a decrease in the rent ceiling when the unit does not comply with habitability standards. CAA recognizes that landlords have a duty under state law to provide habitable premises. However, CAA objects to this regulation's failure to provide any exception to the requirement that the rent ceiling be reduced when the habitability issues in the unit are caused by the tenant, or where the tenant substantially interferes with the landlord's efforts to make repairs. Civil Code § 1941.2 is very clear that in circumstances where the tenant caused the habitability issue, or where the tenant interferes with the landlord's efforts to make repairs, the landlord is not in breach of the warranty of habitability. CAA requests that Civil Code § 1941.2's provisions be incorporated into the regulation so that landlords are not penalized for the conduct of their tenants.

Regulation 874(B)(4)(B)

This section provides that a 20% reduction in the rent ceiling for a unit is required any time a unit violates "subsections (b), (c), and (d) of Civil Code Section 1941." In addition to the issue discussed above, this section is problematic because Civil Code section 1941 has no subsections. Thus, it is not clear what conduct or standards the regulation is referring to.

**RENT BOARD SHOULD DEFER ACTION ON ITEM G-1**

CAA would request that the Rent Board take no action on Item G-1 at the February 21, 2018 meeting. Recognizing that the public comment period on the draft regulations closed only 24 hours before the Rent Board was to vote on the regulations does not give the Rent Board ample and adequate time to review, analyze, and study the public feedback.

CAA appreciates your dedication to the City of Richmond and looks forward to working in partnership with you on these important issues to ensure an effective and fair implementation of Measure L.

Sincerely,



Joshua Howard  
Senior Vice President  
California Apartment Association

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ITEM F-2  
ATTACHMENT 1

TO: CITY OF RICHMOND RENT PROGRAM  
440 CIVIC CENTER PLAZA  
SUITE 200  
RICHMOND, CA 94804

FROM: LORI D. WICKLIFF (LANDLORD)  
5022 STATE AVE  
RICHMOND, CA 94804

THESE ARE SOME THE CHANGES I WOULD LIKE TO RECOMMEND FOR THE DRAFT ADJUSTMENTS REGULATIONS (HANDED OUT) AS OF JANUARY 22, 2018.

**702 ( 1A)**

ADD: 30 DAY NOTICE

**704**

HOUSING AGREEMENT, WRITTEN, ~~ORAL OR IMPLIED~~, TO USE OR OCCUPANCY OF SUCH RENTAL UNIT.  
**\*\*ORAL OR IMPLIED IS NOT A STANDING CONTRACT. I WROTE UP AN ADDENDUM THAT WOULD HELP CLEAR IT UP. I GOT THE IDEA FROM THE BERKELEY RENT BOARD.**

**707(A)**

I WOULD LIKE THIS STATEMENT ADDED

***THE ORIGINAL TENANT SUBLETTING OR ADDING A ROOMMATE THE ENTIRE PREMISES MAY NOT CHARGE THE SUBTENANT MORE THAN THE RENT THE ORIGINAL TENANT PAY THE LANDLORD/OWNER/PROPERTY MGT. THE ORIGINAL TENANT IS RESPONSIBLE FOR THE FULL AMOUNT OF THE RENT TO BE PAID.***

**707(B)**

***ADD: THE NEW SUBTENANT MUST SIGN A LEASE ADDENDUM.***

***THIS ADDENDUM JUST CLARIFIES THE POSITION FOR ADDED TENANT AND THE LANDLORD***

**707(D)**

**ADD: WHEN THE LAST ORIGINAL TENANT TERMINATES HIS/HER LEASE WITH WRITTEN CONSENT TO THE LANDLORD; THE LANDLORD CAN ASK THE SUBTENANT TO PROVIDE PROOF OF INCOME TO COVER THE NEW ESTABLISHED RENT.**

**707 (C)**

**DELETE**

**CONSISTENT WITH CIVIL CODE SECTION 827, SHALL BE EXTENDED FOR UP TO SIX MONTHS FOLLOWING RECEIPT OF THE NOTICE**

LEASE ADDENDUM FOR PURPOSE OF FUTURE

COSTA-HAWKINS RENT INCREASE

(CALIFORNIA CIVIL CODE SECTION 1954.53 et. Seq.)

I, \_\_\_\_\_ (TENANT) hereby acknowledge that I am moving into  
\_\_\_\_\_ (PROPERTY), effective \_\_\_\_\_ (DATE).

I acknowledge that I am not an original tenant as defined by Richmond Rent Board Regulation 701 and California Code Section 1954.53 because I am replacing a vacating tenant, and/or I was not a party to the original rental agreement.

I understand that the landlord may increase the rent and create a new rental agreement/lease with new and different terms when the last original tenant permanently vacates the unit.

I also understand that the LANDLORD may accept rent payments directly from me as part of my tenancy and that this acceptance alone does not constitute a waiver of the landlord’s right to increase the rent pursuant to Richmond Rent Board Regulation and California Civil Code Section 1954.53 when the last original tenant permanently vacates.

I further understand that the Landlord does not waive his/her right to establish a new rent and lease/rental agreement unless his/her right has received written notice of tenancy termination from the last original tenant and thereafter accepts rent before serving notice of a new rent.

For questions about this form, or its use, please contact the Richmond Rent Board  
rentboard@ci.richmond.ca.us

DATED: \_\_\_\_\_

LANDLORD: \_\_\_\_\_

DATED: \_\_\_\_\_

TENANT: \_\_\_\_\_

**ITEM F-2  
ATTACHMENT 1**

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

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

Sent: Tuesday, February 20, 2018 9:57 AM

To: Rent Control; [NicolusTraylor@ci.richmond.ca.us](mailto:NicolusTraylor@ci.richmond.ca.us); Paige Roosa

Subject: ATTN: Rent Board Members

To: Members of the Rent Board

RE: Sherry Zalabak Letter Submitted 2/11/18 RE: Changes in number of Tenants

I write to modify my position as stated in the above correspondence. Since the writing of that letter my research reveals that there are far more unit rents frozen by "historically low rents". Some units rent as low as \$400. pr month. If the 25% compensation for adding a tenant is passed without regard to MNOI, Fair Rate of Return, etc. this would be an insufficient increase to address the added costs pr. tenant to the Housing Provider. The content of my letter of 2/11/18 demonstrates the dramatic increase in service costs during the past several years, and did not include "annual increases in property taxes", "special assessments" and alarming hike in "sewer assessments" attached to water bills.

Given this data I propose that the recommendation of a 25% increase be the MINIMUM increase. It is only prudent and fair to consider the specifics of a situation when making a deserving and reasonable decision. Please consider this in your discussions and decisions.

Sherry Zalabak,

Member AURHP "Association of United Richmond Housing Providers"

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# ITEM F-2 ATTACHMENT 1

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

From: Sherry Zalabak [<mailto:sherz@comcast.net>]

Sent: Tuesday, February 20, 2018 8:01 AM

To: [rentprogram20@gmail.com](mailto:rentprogram20@gmail.com)

Subject: Attention Board Members

To: Members of the Richmond Rent Board

To: Nicolas Traylor

My name is Sherry Zalabak and I bought a triplex in Richmond Annex in 2012. At that time one unit was rented for \$1,100 pr. month. It was in need of renovation but it was occupied. The other two units were uninhabitable. Sections of roof were missing and both apts. were flooded with rainwater, windows were broken, and appliances had been stolen.

I immediately put on a new roof, new gutters and downspouts. I built two new porches, deck and stairs. I replaced 18 windows with new double pain windows with matching shades. I replaced the kitchen appliances and replaced the kitchen floors. I upgraded plumbing, remodeled two bathrooms, painted the inside of both units and painted the building's exterior. I replaced the exterior doors, replaced all wood supports for the two-story stairs, installed an exterior drainage system, added a sump-pump. I replaced 3 water heaters and I refinished all hardwood floors. I landscaped the backyard and installed an irrigation system, bought lawn furniture, picnic table, hammock and lounge chairs. I rehabbed the washer and dryer in the laundry room. And finally, I added exterior lighting. I am proud of what I did and so are my tenants.

When the original tenant decided to move in 2013, I did the same renovations to his unit. I had not raised the rent the entire time he was there. In 2014, after the renovations were completed, I rented it to a single mother for \$1,400. The unit should have rented for \$1,650, but, like the previous tenant (and my mother), she was a single parent and going through a rough patch financially. Once she got back on her feet (she actually managed to buy rental property of her own), I raised the rent to \$1650 in order to start paying for the repairs and improvements I had made.

The Rent Board requires me to roll back the rent to \$1,400. Please explain to me why? I am a great landlord. I have spent these last several years devoting my time (what's left of it) and using my own labor and spending my rental income to create a pleasing home for three households. What have I done to deserve a roll back? Should I have taken advantage of folks when I could? What satisfaction would that give me? I can only guess that this Rent Ordinance is geared to corporate entities whose mission is only the financial bottom line.

I was relieved to read that Housing Providers can petition for rent increases. Yet upon studying the conditions and requirements I am sorry to say that this appears to be an empty claim. The "Home Owner Protection" as claimed by the drafters is replete with prohibitive requirements, restrictions and exclusions. I see only a mountain of obstacles and bureaucratic road blocks to the granting of a rent increase. Do I have all of the records and receipts required...probably not! Do I qualify within the arbitrary time limits and rigid restrictions regarding capital expenses, repairs and improvements. Probably not! Does the time period for capital expense include mine (2012 and 2013)? Is there any flexibility or a provision for "reasonableness"? Probably not!

**ITEM F-2**  
**ATTACHMENT 1**

Please consider that many of us must repair and improve our properties piece-meal: when we have the money, when interest rates are low or when a tenant moves. We have no control over some of these events. All of these apply to me and to most other small-time Housing Providers. Should we be penalized for falling just outside the boundaries or are we allowed the opportunity of "reasonableness" ?

Respectfully Submitted,  
Sherry Zalabak—Member AURHP



# AGENDA REPORT

**DATE:** February 28, 2018

**TO:** Chair Gray and Members of the Rent Board

**FROM:** Nicolas Traylor, Executive Director

**SUBJECT:** PROPOSED CONTRACT AMENDMENT WITH KENNETH BAAR FOR PREPARATION OF PROPOSED RENT BOARD REGULATIONS

## **STATEMENT OF THE ISSUE:**

The Rent Board must adopt regulations governing the petition process for upward and downward rent adjustments. The Rent Program is requesting approval of a sole source contract with Kenneth Baar to prepare particularly complex rent adjustment regulations concerning the definition of a fair rate of return and rent adjustment standards to address petitions submitted on the grounds of historically low rents. Dr. Baar prepared and presented memoranda and proposed regulations to the Rent Board concerning fair return regulations on December 20, 2017, and February 21, 2018. The Executive Director is requesting a contract amendment to increase the amount of the contract to ensure adequate funds to cover the preparation of Historically Low Rent and Capital Improvement memoranda and draft regulations. In accordance with the City's procurement policies, Board approval is required of a sole source contract in an amount greater than \$9,999.

## **RECOMMENDED ACTION:**

APPROVE a sole source contract amendment with Kenneth Baar in the amount of \$20,001 for the preparation of rent adjustment regulations for consideration by the Rent Board, for a total contact amount not to exceed \$30,000.

## **FISCAL IMPACT:**

Contracts with subject matter experts for the preparation of proposed rent adjustment regulations for consideration by the Rent Board are included in the amended 2017-18 Rent Program Budget and will be funded by Rental Housing Fee revenue. Since the Rent Program is still in the process of billing and collection of the Rental Housing Fee, presumably the funds needed for this contract will be borrowed from the City's General Fund and paid back in accordance with the Reimbursement Agreement between the Rent Board and City of Richmond adopted by the Rent Board on December 20, 2017.

**DISCUSSION:**

The Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance (“Ordinance”), codified in Chapter 11.100 of the Municipal Code, establishes limits on the amount of rent that may be charged for most multifamily residential rental units in the City of Richmond. While Landlords in compliance with the Ordinance and all regulations adopted by the Rent Board are guaranteed the Annual General Adjustment rent increase each year, the Ordinance permits Landlords to petition for an individual rent adjustment in the Maximum Allowable Rent.

Landlords have a constitutional right to a fair rate of return (“Fair Return”) on rental property investments; however, the courts have not required that one particular “fair return” standard be employed by jurisdictions with rent control policies. As such, the Rent Board must adopt regulations to define the Fair Return standards used to adjudicate rent adjustment petitions.

Kenneth Baar is a national expert on Fair Return standards. He has prepared Fair Return reports for 18 California jurisdictions in fair return cases and his testimony on fair return issues has been frequently cited in published California appellate court opinions. Rent Program staff members are confident that Dr. Baar is the only individual qualified to prepare these regulations, and that contracting with another individual or attempting to draft regulations without the assistance of subject matter experts may incur unnecessary legal challenge.

In December, the Rent Program held two well-attended community workshops regarding setting standards for changes in the maximum rent. Feedback and questions gathered from participants has been transmitted to Kenneth Baar to inform the preparation of proposed Rent Board regulations. Additional information is accessible at <http://www.ci.richmond.ca.us/3521/Rent-Adjustment-Regulations>.

**DOCUMENTS ATTACHED:**

Attachment 1 – Contract Amendment

Attachment 2 – Original Contract

Attachment 3 – Sole Source Justification

# AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: February 28, 2018

Final Decision Date Deadline: February 28, 2018

**STATEMENT OF THE ISSUE:** The Rent Board must adopt regulations governing the petition process for upward and downward rent adjustments. The Rent Program is requesting approval of a sole source contract with Kenneth Baar to prepare particularly complex rent adjustment regulations concerning the definition of a fair rate of return and rent adjustment standards to address petitions submitted on the grounds of historically low rents. Dr. Baar prepared and presented memoranda and proposed regulations to the Rent Board concerning fair return regulations on December 20, 2017, and February 21, 2018. The Executive Director is requesting a contract amendment to increase the amount of the contract to ensure adequate funds to cover the preparation of Historically Low Rent and Capital Improvement memoranda and draft regulations. In accordance with the City's procurement policies, Board approval is required of a sole source contract in an amount greater than \$9,999.

## 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

- |   |  |  |
|---|--|--|
| <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:** APPROVE a sole source contract amendment with Kenneth Baar in the amount of \$20,001 for the preparation of rent adjustment regulations for consideration by the Rent Board, for a total contact amount not to exceed \$30,000. – Rent Program (Nicolas Traylor 620-6564).

AGENDA ITEM NO:

**F-3.**

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**ITEM F-3  
ATTACHMENT 1**

**CITY OF RICHMOND RENT BOARD  
CONTRACT AMENDMENT**

Department: Rent Program	Project Manager: Nicolas Traylor
Project Manager E-mail: Nicolas_traylor@ci.richmond.ca.us	Project Manager Phone No: (510) 620-6576
Vendor No: 12940                      PR No:	P.O./Contract No: 4003
Description of Services: Provide consultation services to Rent Program Department.	
Amendment No. 1 modifies the payment limit.	

The parties to this contract amendment do mutually agree and promise as follows:

1. Parties. The parties to this Contract are the City Of Richmond Rent Board (herein referred to as the "City") and the following named Contractor:

Company Name: Kenneth Baar

Street Address: 17 Katrine Street

City, State, Zip Code: West End, Queensland, 4101 Australia

Contact Person: Kenneth Baar

Telephone: 510-717-2025

Email: kenbaar@aol.com

Business License No: 40055945

Expiration Date: 11/14/18

A California  corporation,  limited liability corporation  general partnership,  limited partnership,  individual,  non-profit corporation,  
 individual dba as [specify:] \_\_\_\_\_,  
 other [specify:] \_\_\_\_\_

2. Purpose. This Contract Amendment is being entered into to amend the Contract between City and Contractor which was approved by the Rent Board of the City of Richmond or executed by the Executive Director on November 20, 2017, which original term commenced on November 20, 2017, and terminates June 30, 2018, with an original contract payment limit of \$9,999.00. Said contact shall hereinafter be referred to as the "Original Contact" and is incorporated herein by this reference.
3. Original Contract Provisions. The parties hereto agree to continue to abide by those terms and conditions of the Original Contract, and any amendments thereto, which are unaffected by this Contract Amendment.
4. Amendment Provisions. This Contract Amendment is subject to the Amendment Provisions attached hereto, which are incorporated by reference, and which control over any conflicting

**ITEM F-3  
ATTACHMENT 1**

provisions of the Original Contract, or any amendment thereto.

- 5. City of Richmond Business License Active Status Maintained. Pursuant to Municipal Code Section 7.04.030, the Contractor must maintain its City of Richmond business license for this Contract Amendment to be deemed in effect.
- 6. Insurance Coverage Updated and Maintained. Pursuant to the Original Contract, the Contractor shall provide the City with updated insurance certificates, and the Contractor shall maintain insurance coverage, for this Contract Amendment to be deemed in effect.
- 7. Signatures. These signatures attest the parties' agreement hereto:

RENT BOARD:

CONTRACTOR:

By: \_\_\_\_\_

(\* The Corporation Chairperson of the Board, President or Vice President should sign below)

Title: Executive Director

By: \_\_\_\_\_

I hereby certify that this Contract has been approved by the Rent Board or the Executive Director.

Title: Principal

Date Signed: \_\_\_\_\_

By: \_\_\_\_\_

Board Clerk

(\* The Corporation Chief Financial Officer, Secretary or Assistant Secretary should sign below)

Approved as to form:

By: \_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Board Legal Counsel

Date Signed: \_\_\_\_\_

(NOTE: Pursuant to California Corporations Code Section 313, if Contractor is a corporation or nonprofit organization, this Contract (1) must be signed by (a) the Chairperson of the Board, President or Vice-President and (b) the Secretary any Assistant Secretary, the Chief Financial Officer or any Assistant Treasurer.

LIST OF ATTACHMENTS:

Amendment Provisions                      Exhibit A

Standard Contract/EJ/TE 9-26-07

**EXHIBIT A  
AMENDMENT PROVISIONS**

**ITEM F-3**  
**ATTACHMENT 1**

1. Paragraph 3 (Payment Limit) is hereby amended to increase the payment limit by \$20,001. Paragraph 3 of the Original Contract is hereby amended to read as follows:

“3. Payment Limit. City’s total payments to Contractor under this Contract shall not exceed \$30,000. City shall not pay for services that exceed the Contract Payment Limit unless a contract amendment has been approved by the City Council, Rent Board, or Executive Director.”

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CITY OF RICHMOND RENT BOARD  
STANDARD CONTRACT

Department: Rent Program	Project Manager: Nicolas Traylor
Project Manager E-mail: Nicolas_traylor@ci.richmond.ca.us	Project Manager Phone No: (510) 620-6576
Vendor No: 12940      PR No:	P.O./Contract No: 4003
Description of Services: Provide consultation services to Rent Program Department.	

The parties to this STANDARD CONTRACT do mutually agree and promise as follows:

1. **Parties.** The parties to this Contract are the City Of Richmond Rent Board (herein referred to as the "City") and the following named Contractor:

Company Name: Kenneth Baar

Street Address: 17 Katrine Street

City, State, Zip Code: West End, Queensland, 4101 Australia

Contact Person: Kenneth Baar

Telephone: 510-717-2025

Email: kenbaar@aol.com

Business License No: 40055945

Expiration Date: 11/14/18

A California  corporation,  limited liability corporation  general partnership,  limited partnership,  individual,  non-profit corporation,  
 individual dba as [specify:] \_\_\_\_\_,  
 other [specify:] \_\_\_\_\_

2. **Term.** The effective date of this Contract is November 20, 2017, and it terminates June 30, 2018, unless terminated as provided herein.
3. **Payment Limit.** City's total payments to Contractor under this Contract shall not exceed \$9,999. City shall not pay for services that exceed the Contract Payment Limit unless a contract amendment has been approved by the Rent Board or Executive Director.
4. **Contractor's Obligations.** Contractor shall provide those services and carry out that work described in the Service Plan (Exhibit A) which is attached hereto and is incorporated herein by reference, subject to all the terms and conditions contained or incorporated herein.
5. **City Obligations.** City shall make to the Contractor those payments described in the Payment Provisions (Exhibit B) which are attached hereto and are incorporated herein by reference, subject to all the terms and conditions contained or incorporated herein.

For the Contract between the City of  
Richmond Rent Board and

KENNETH BAAR

- 6. Authorized Representatives and Notices. This Contract is subject to the Authorized Representatives and Notices Provisions (Exhibit C) which are attached hereto and are incorporated herein by reference.
- 7. General Conditions. This Contract is subject to the General Conditions (Exhibit D) which are attached hereto and are incorporated herein by reference, subject to all the terms and conditions contained or incorporated herein.
- 8. Special Conditions. This Contract is subject to the Special Conditions (Exhibit E) (if any) which are attached hereto and are incorporated herein by reference, subject to all the terms and conditions contained or incorporated herein.
- 9. Insurance Provisions. This Contract is subject to the Insurance Provisions (Exhibit F) which are attached hereto and are incorporated herein by reference.
- 10. Signatures. These signatures attest the parties' Contract hereto:

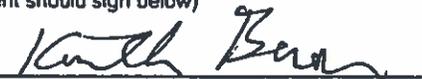
RENT BOARD:

CONTRACTOR:

By: 

(\* The Corporation Chairperson of the Board, President or Vice President should sign below)

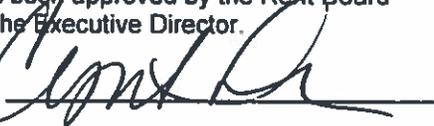
Title: Executive Director

By: 

Title: Principal

I hereby certify that this Contract has been approved by the Rent Board or the Executive Director.

Date Signed: Nov 30, 2017

By: 

Board Clerk

(\* The Corporation Chief Financial Officer, Secretary or Assistant Secretary should sign below)

Approved as to form:

By: \_\_\_\_\_

By: 

Board Legal Counsel

Title: \_\_\_\_\_

Date Signed: \_\_\_\_\_

(NOTE: Pursuant to California Corporations Code Section 313, if Contractor is a corporation or nonprofit organization, this Contract (1) must be signed by (a) the Chairperson of the Board, President or Vice-President and (b) the Secretary any Assistant Secretary, the Chief Financial Officer or any Assistant Treasurer.

**ITEM F-3  
ATTACHMENT 2**

For the Contract between the City of  
Richmond Rent Board and

**KENNETH BAAR**

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**LIST OF ATTACHMENTS:**

Service Plan	Exhibit A
Payment Provisions	Exhibit B
Authorized Representatives and Notices	Exhibit C
General Conditions	Exhibit D
Special Conditions	Exhibit E
Insurance Provisions	Exhibit F

Standard Contract/EJ/TE 9-26-07

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**EXHIBIT A  
SERVICE PLAN**

Contractor shall, to the satisfaction of the Rent Board or Executive Director, perform the following services and be compensated as outlined below:

**SCOPE OF SERVICES**

1. Prepare a memo and agenda report for consideration by the Rent Board on "fair return standards" as referenced in Richmond Municipal Code Section 11.100.070, including discussion of policy and legal issues.
2. Draft Rent Board regulations setting forth substantive standards applicable to fair return applications.
3. Attend a public hearing on fair return issues subject to the condition that the hearing is held between December 20, 2017, and January 12, 2018, either on December 20<sup>th</sup> or a date agreed upon by Contractor and the City.
4. Provide comments and analysis on other policy and legal matters as agreed to by contractor and Executive Director.

**RATE**

Contractor will be compensated at a rate of \$290 per hour, in an amount not to exceed \$9,999, with the approval of the Executive Director.

Contractor shall not bill for travel time.

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EXHIBIT B  
PAYMENT PROVISIONS

**{PLEASE NOTE THAT THE RENT PROGRAM SHALL NOT PAY FOR SERVICES THAT EXCEED THE CONTRACT PAYMENT LIMIT UNLESS A CONTRACT AMENDMENT HAS BEEN APPROVED BY THE RENT BOARD OR EXECUTIVE DIRECTOR}**

1. Provided Contractor is not in default under this Contract, Contractor shall be compensated as provided below.
2. Any and all payments made pursuant to this Contract shall be subject to the Contract Payment Limit. The Payment Limit includes expenses (phones, photo copying, meals and travel, etc.) Invoices, shall be adequately detailed, based on accurate records, and be in a form reasonably satisfactory to the City. Contractor may be required to provide back-up material upon request.
3. Contractor shall submit timely invoices to the following address:

Attention: City of Richmond Finance Department - Accounts Payable

Project Manager: Nicolas Traylor

P.O. Box 4046

Richmond, CA 94804

4. All invoices that are submitted by Contractor shall be subject to the approval of the City Project Manager, Nicolas Traylor before payments shall be authorized.
5. The City will pay invoice(s) within 45 days after completion of services to the City satisfaction. The City shall not pay late fees or interest.
6. A Richmond business license shall be obtained before any payment under this Contract shall be authorized and the business license must be kept current during the term of this Contract for payments to continue to be authorized.
7. All insurance coverage required by this Contract shall be provided by

the Contractor before this Contract shall be executed by the City.  
The insurance coverage must be kept current during the term of this  
Contract for payments to continue to be authorized.

**EXHIBIT C  
AUTHORIZED REPRESENTATIVES AND NOTICES**

1. **Notices.** All notices, demands, statements, or communications provided for by this Contract shall be in writing and may be delivered by deposit in the United States mail, postage prepaid. Notices to the City shall be addressed to the Department Head and (as delineated below in section 1.1) to the project manager responsible for the administration of or the supervision of the scope of work under this Contract. Notices to the Contractor shall be emailed to Kenbaar@aol.com and if Contractor does not confirm receipt within two days, shall be sent by overnight mail to 449 15<sup>th</sup> street, suite 301, Oakland, Ca. 94612, and addressed to the party designated by Contractor (as delineated below in section 1.2). Notice to City shall be deemed delivered (a) as of the fifth business day after mailing by United States certified mail, postage prepaid, addressed to the proper party; or (b) as of 12:00 p.m. on the second business day immediately after the day it is deposited with and accepted by Federal Express, or a similar overnight courier service, addressed to the proper party and marked for next business day delivery. For the purposes of this Contract, a "business day" means any day Monday through Friday that is not a holiday recognized by the federal government or the State of California.

- 1.1 City hereby designates as its Authorized Representative the Project Manager whose name and address are as follows:

Nicolas Traylor

City Of Richmond Rent Program

440 Civic Center Plaza, Suite 200

Richmond, CA 94804

- 1.2 CONTRACTOR hereby designates as its Authorized Representative the Project Manager whose name and address are as follows:

Kenneth Baar

kenbaar@aol.com

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EXHIBIT D  
GENERAL CONDITIONS

1. **Independent Contractor.** Contractor acknowledges, represents and warrants that Contractor is not a regular or temporary employee, joint venturer or partner of the City, but rather an independent Contractor. This Contract shall not be construed to create an agency, servant, employee, partnership, or joint venture relationship. As an independent Contractor, Contractor shall have no authority to bind City to any obligation or to act as City's agent except as expressly provided herein. Due to the independent Contractor relationship created by this Contract, City shall not withhold state or federal income taxes, the reporting of which shall be Contractor's sole responsibility.
2. **Brokers.** Contractor acknowledges, represents and warrants that Contractor has not hired, retained or agreed to pay any entity or person any fee, commission, percentage, gift, or any other consideration, contingent upon or resulting from the award or making of this Contract.
3. **City Property.** The rights to applicable plans, drawings, reports, calculations, data, specifications, videos, graphics or other materials prepared for or obtained pursuant to this Contract, which, upon request, are to be delivered to City within a reasonable time, shall be deemed assigned to City. If applicable, Contractor shall prepare check prints upon request. Notwithstanding the foregoing, Contractor shall not be obligated to provide to City proprietary software or data which Contractor has developed or had developed for Contractor's own use; provided, however, that Contractor shall, pursuant to Section 15 below, indemnify, defend and hold harmless City from and against any discovery or Public Records Act request seeking the disclosure of such proprietary software or data.
4. **Patents, Trademarks, Copyrights and Rights in Data.** Contractor shall not publish or transfer any materials, discoveries, developments, concepts, designs, ideas, know how, improvements, inventions and/or original works of authorship resulting from activities supported by this Contract without the express prior written consent of the City Manager. If anything resulting from activities supported by this Contract is patentable, trademarkable, copyrightable or otherwise legally protectable, City reserves the exclusive right to seek such intellectual property rights. Notwithstanding the foregoing, Contractor may, after receiving City's prior written consent, seek patent, trademark, copyright or other intellectual property rights on anything resulting from activities supported by this Contract. However, City reserves, and Contractor irrevocably grants, a nonexclusive, fully paid-up, royalty-free, assumable, perpetual, worldwide license, with the right to transfer, sublicense, practice and exploit said license and the right to make, have made, copy, modify, make derivative works of, use, sell, import, and otherwise distribute under all applicable intellectual properties

without restriction of any kind said license.

Contractor further agrees to assist City, at City's expense, in every proper way to secure the City's rights in any patents, trademarks, copyrights or other intellectual property rights relating thereto, including the disclosure to City of all pertinent information and data with respect thereto. Contractor shall also assist City in the execution of all applications, specifications, oaths, assignments, recordations, and all other instruments which City shall deem necessary in order to apply for, obtain, maintain and transfer such rights, or if not transferable, to waive such rights. Contractor shall further assist City in the execution of all applications, specifications, oaths, assignments, recordations and all other instruments which City shall deem necessary in order to assign and convey to City, and any assigns and nominees the sole and exclusive right, title and interest in and to any patents, trademarks, copyrights or other intellectual property rights relating thereto. Contractor further agrees that its obligation to execute or cause to be executed, when it is in Contractor's power to do so, any such instruments or papers shall continue during and at all times after the end of Contractor's services and until the expiration of the last such intellectual property right. Contractor hereby irrevocably designates and appoints City, and its duly authorized officers, agents and servants, as its agent and attorney-in-fact, to act for and in its behalf and stead to execute and file any such applications and to do all other lawfully permitted acts to further the application for, prosecution, issuance, maintenance or transfer of letters of patents, copyright and other registrations. This power of attorney is coupled with an interest and shall not be affected by Contractor's subsequent incapacity.

5. Inspection. Contractor's performance, place of business and records pertaining to this Contract are subject to monitoring, inspection, review and audit by authorized representatives of the CITY, the State of California, and the United States Government.

If the project or services set forth in Exhibit A shall be performed on City or other public property, City shall have the right to inspect such work without notice. If such project or services shall not be performed on City or other public property, City shall have the right to inspect such work upon reasonable notice.

6. Services. The project or services set forth in Exhibit A shall be performed to the full satisfaction and approval of City. In the event that the project or services set forth in Exhibit A are also itemized by price, City, in its sole discretion, may, upon notice to Contractor, delete certain items or services set forth in Exhibit A, in which case there shall be a corresponding reduction in the amount of compensation paid to Contractor.

Contractor shall, at its own cost and expense, furnish all facilities and equipment necessary for Contractor to complete the project or perform the services required herein, unless otherwise provided in Exhibit A.

7. **Records.** Contractor shall keep and make available for inspection and copying by authorized representatives of the City, the State of California, and the United States Government, the Contractor's regular business records and such additional records pertaining to this Contract as may be required by the City.

Contractor shall retain all documents pertaining to this Contract for a period of five (5) years after this Contract's termination (or for any further period that is required by law) and until all Federal or State audits are complete and exceptions resolved for this contract's funding period. Upon request, CONTRACTOR shall make these records available to authorized representatives of the CITY, the State of California, and the United States Government.

Contractor shall keep full and detailed accounts, maintain records, and exercise such controls as may be necessary for proper financial management under this Contract. The Contractor's accounting and control systems shall be satisfactory to City. Contractor's accounting systems shall conform to generally accepted accounting principles and all records shall provide a breakdown of total costs charged under this Contract, including properly executed payrolls, time records, utility bills, invoices and vouchers. The City shall be afforded prompt access to Contractor's records, books, and Contractor shall preserve such project records for a period of at least five (5) years after the termination of this Contract, or for such longer period as may be required by law.

Contractor shall permit City and its authorized representatives and accountants to inspect, examine and copy Contractor's books, records, accounts, correspondence, instructions, drawings, receipts, subcontracts, purchase orders, vouchers, memoranda and other data relating to the project or services set forth in Exhibit A, and any and all data relevant to this Contract at any reasonable time for the purpose of auditing and verifying statements, invoices, or bills submitted by Contractor pursuant to this Contract and shall provide such assistance as may be reasonably required in the course of such inspection. Contractor shall also allow City access to the record keeping and accounting personnel of Contractor. City further reserves the right to examine and re-examine said books, records, accounts, and data during the five (5) year period following the termination of this Contract; and Contractor shall in no event dispose of, destroy, alter, or mutilate said books, records, accounts, and data in any manner whatever for five (5) years after the termination of this Contract.

Pursuant to California Government Code § 10527, the parties to this Contract shall be subject to the examination and audit of representatives of the Auditor General of the State of California for a period of three (3) years after final payment under this Contract. The examination and audit shall be confined to those matters connected with the performance of this Contract including, but not limited to, the cost of administering this Contract.

8. **Changes and Extra Work.** All changes and/or extra work under this Contract shall be performed and paid for in accordance with the following:

Only the City Council or the City Manager may authorize extra and/or changed work. Contractor expressly recognizes that other City personnel are without authorization to either order extra and/or changed work or waive contract requirements. Failure of Contractor to secure the authorization for such extra and/or changed work shall constitute a waiver of any and all right to adjustment in contract price due to such unauthorized work and Contractor thereafter shall be entitled to no compensation whatsoever for performance of such extra and/or changed work.

If Contractor is of the opinion that any work which Contractor has been directed to perform is beyond the scope of this Contract and constitutes extra work, Contractor shall promptly notify City of the fact. The City shall make a determination as to whether or not such work is, in fact, beyond the scope of this Contract and constitutes extra work. In the event that City determines that such work does constitute extra work, City shall provide extra compensation to Contractor on a fair and equitable basis. A change order or Contract Amendment providing for such compensation for extra work shall be negotiated between City and Contractor and executed by Contractor and the appropriate City official.

In the event City determines that such work does not constitute extra work, Contractor shall not be paid extra compensation above that provided herein and if such determination is made by City staff, said determination may be appealed to the City Council; provided, however, a written appeal must be submitted to the City Manager within five (5) days after the staff's determination is sent to Contractor. Said written appeal shall include a description of each and every ground upon which Contractor challenges the staff's determination.

9. **Additional Assistance.** If this Contract requires Contractor to prepare plans and specifications, Contractor shall provide assistance as necessary to resolve any questions regarding such plans and specifications that may arise during the period of advertising for bids, and Contractor shall issue

any necessary addenda to the plans and specifications as requested. In the event Contractor is of the opinion that City's requests for addenda and assistance is outside the scope of normal services, the parties shall proceed in accordance with the changes and extra work provisions of Section 8 of these General Conditions.

10. Professional Ability. Contractor acknowledges, represents and warrants that Contractor and its employees are skilled and able to competently provide the services hereunder, and possess all professional licenses, certifications, and approvals necessary to engage in their occupations. City has relied upon the professional ability and training of Contractor as a material inducement to enter into this Contract. Contractor shall perform in accordance with generally accepted professional practices and standards of Contractor's profession. In the event that City, in its sole discretion, desires the removal of any person employed or retained by Contractor to perform services hereunder, such person shall be removed immediately upon receiving notice from City.
11. Business License. Contractor shall obtain a Richmond Business License before performing any services required under this Contract. The failure to so obtain such license shall be a material breach of this Contract and grounds for immediate termination by City; provided, however, that City may waive the business license requirement in writing under unusual or extraordinary circumstances without necessitating any modification of this Contract to reflect such waiver.
12. Termination Without Default. Notwithstanding any provision herein to the contrary, City may, in its sole and absolute discretion and without cause, terminate this Contract at any time prior to completion by Contractor of the project or services hereunder, immediately upon written notice to Contractor. Contractor may terminate this Contract at any time in its sole and absolute discretion and without cause upon 30 days' written notice to City. In the event of termination by either party, Contractor shall be compensated for: (1) all authorized work satisfactorily performed prior to the effective date of termination; (2) necessary materials or services of others ordered by Contractor for this Contract, prior to receipt of notice of termination, irrespective of whether such materials or services of others have actually been delivered, provided that Contractor is not able to cancel such orders. Compensation for Contractor in such event shall be determined by City in accordance with the percentage of the project or services completed by Contractor; and all of Contractor's finished or unfinished work product through the time of the City's last payment shall be transferred and assigned to City. Additionally, in the event of such termination, the City may proceed with the work in any reasonable manner it chooses.

For the Contract between the City of  
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KENNETH BAAR

13. Termination in the Event of Default. Should Contractor fail to perform any of its obligations hereunder, within the time and in the manner provided or otherwise violate any of the terms of this Contract, City may immediately terminate this Contract by giving written notice of such termination, stating the reasons for such termination. Contractor shall be compensated as provided in Section 12 of these General Conditions; provided, however, there shall be deducted from such amount the amount of damage, including attorney's fees, expert witness fees and costs, if any, sustained by City by virtue of Contractor's breach of this Contract. Additionally, in the event of such termination, the City may proceed with the work in any reasonable manner it chooses.
14. Conflict of Interest. Contractor acknowledges, represents and warrants that Contractor shall avoid all conflicts of interest (as defined under any federal, state or local statute, rule or regulation, or at common law) with respect to this Contract. Contractor further acknowledges, represents and warrants that no City official or employee has any economic interest, as defined in Title 2, California Code of Regulations §§ 18703.1 through 18703.5, with Contractor that would invalidate this Contract. Contractor acknowledges that in the event that Contractor shall be found by any judicial or administrative body to have any conflict of interest (as defined above) with respect to this Contract, all consideration received under this Contract shall be forfeited and returned to City forthwith. This provision shall survive the termination of this Contract for one (1) year.
15. Indemnification.
- (a) If this Contract is a contract for design professional services subject to California Civil Code Section 2782.8(a) and Contractor is a design professional, as defined in California Civil Code Section 2782.8(b)(2), Contractor shall hold harmless, defend and indemnify the City, its officers, agents, employees, and volunteers from and against any and all claims, damages, losses, and expenses including attorneys' fees arising out of, or pertaining to, or relating to the negligence, recklessness, or willful misconduct of the Contractor, except where caused by the active negligence, sole negligence, or willful misconduct of the City. To the fullest extent permitted by law, Contractor shall immediately defend and indemnify the City and its officers, agents, employees, and volunteers from and against any and all liabilities, regardless of nature or type, that arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of the Contractor, or its employees, agents, or subcontractors. Liabilities subject to the duties to defend and indemnify include, without limitation, any and all claims, losses, damages, penalties, fines, and judgments; associated investigation and administrative expenses; defense costs, including but not limited to reasonable attorneys' fees; court costs; and costs of alternative dispute resolution. Contractor's obligation to indemnify applies unless it is finally adjudicated that the liability was caused by the sole active negligence or sole willful misconduct of an indemnified party.
- (b) If this Contract is not a contract for design professional services subject to California Civil Code Section 2782.8(a) or Contractor is not a design professional as defined in California Civil Code Section 2782.8(b)(2), Contractor shall indemnify, defend, and hold harmless the City, its officers, agents, employees and volunteers from any and all claims, suits, or actions of every name, kind and description, brought forth on account of injuries to or death of any

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person or damage to property arising from or connected with the willful misconduct, negligent acts, errors or omissions, ultra-hazardous activities, activities giving rise to strict liability, or defects in design by Contractor or any person directly or indirectly employed by, or acting as, the agent for Contractor in the performance of this Contract, including the concurrent or successive passive negligence of the City, its officers, agents, employees or volunteers.

- (c) It is understood that the duty of Contractor to indemnify and hold harmless includes the duty to defend as set forth in Section 2778 of the California Civil Code. Contractor shall be obligated to defend, in all legal, equitable, administrative, or special proceedings, with counsel approved by the City, the City and its officers, agents, employees, and volunteers, immediately upon tender to Contractor of the claim in any form or at any stage of an action or proceeding, whether or not liability is established. An allegation or determination that persons other than Contractor are responsible for the claim does not relieve Contractor from its separate and distinct obligation to defend under this Section 15. The obligation to defend extends through final judgment, including exhaustion of any appeals. The defense obligation includes an obligation to provide independent counsel if Contractor asserts that liability is caused in whole, or in part, by the negligence or willful misconduct of an indemnified party.
- (d) The review, acceptance or approval of the Contractor's work or work product by any indemnified party shall not affect, relieve or reduce the Contractor's indemnification or defense obligations. This Section 15 survives completion of the services or the termination of this Contract. The provisions of this Section 15 are not limited by, and do not affect, the provisions of this Contract relating to insurance.
- (e) Acceptance of insurance certificates and endorsements required under this Contract does not relieve Contractor from liability under this Section 15. This Section 15 shall apply whether or not such insurance policies are determined to be applicable to any such damages or claims for damages.
16. Safety. Contractor acknowledges that the City is committed to the highest standards of workplace safety. Contractor shall perform all work hereunder in full compliance with applicable local, state and federal safety requirements including but not limited to Occupational Safety and Health Administration requirements, and shall assume sole and complete responsibility for the safety of Contractor's employees and any subcontractor's employees. If a death, serious personal injury or substantial property damage occurs in connection with the performance of this Contract, Contractor shall immediately notify the City by telephone.
17. Insurance. Insurance requirements are set forth in Exhibit F to this Contract. Contractor shall abide by the insurance requirements set forth in said Exhibit F.
18. Non-Liability of Officials and Employees of the City. No official or employee of the City shall be personally liable for any default or liability under this Contract.

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19. Compliance with Laws. Contractor shall comply with all federal, state and local laws, statutes, ordinances, rules and regulations, and the orders and decrees of any courts or administrative bodies or tribunals, with respect to this Contract, including without limitation environmental laws, employment discrimination laws and prevailing wage laws. Compliance under this provision includes compliance with all provisions of the Richmond Municipal Code ("Municipal Code"), including Chapters 2.50, 2.52, 2.56, and 2.60, if applicable.

Contractor acknowledges that under § 2.60.070 of the Municipal Code ("Living Wage Ordinance"), Contractor shall promptly provide to City documents and information verifying its compliance with the Living Wage Ordinance. Also as prescribed in § 2.60.070, Contractor shall notify each of its affected employees with regards to the wages that are required to be paid pursuant to the Living Wage Ordinance.

Contractor shall comply with § 2.28.030 of the Municipal Code, obligating every Contractor or subcontractor under a contract or subcontract with the City for public work or for goods or for services to refrain from discriminatory employment or subcontracting practices on the basis of race, color, sex, sexual orientation, religious creed, national origin or ancestry of any employee, any applicant for employment or any potential subcontractor.

Contractor acknowledges that the City's Drug Free Workplace Policy, Violence in the Workplace Policy and the Policy Against Workplace Harassment, are available on the City's website at <http://www.ci.richmond.ca.us/workplacepolicies>. Contractor agrees to abide by the terms and conditions of said policies.

20. Limitations upon Subcontracting and Assignment. This Contract binds the heirs, successors, assigns and representatives of Contractor. The Contractor shall not enter into subcontracts for any work contemplated under this Contract and shall not assign this Contract, nor any portion hereof or monies due or to become due, without the prior written consent of the City Council or its designee.

Contractor acknowledges that the services which Contractor shall provide under this Contract are unique, personal services which, except as otherwise provided herein, Contractor shall not assign or sublet to any other party without the prior written approval of City, which approval may be withheld in City's sole and absolute discretion. In the event that City, in writing, approves any assignment or subletting of this Contract or the retention of subcontractors by Contractor, Contractor shall provide to City upon request copies of each and every subcontract contract prior to the execution thereof by Contractor and subcontractor. Any assignment by Contractor of any or all of its rights under this Contract without first obtaining City's prior written consent shall be a default under this Contract.

The sale, assignment, transfer or other disposition of any of the issued and outstanding capital stock of Contractor (if applicable), or of the interest of any general partner or joint venturer or syndicate member if Contractor is a partnership or joint-venture or syndicate, which shall result in a change of control of Contractor, shall be deemed an assignment. For this purpose, control shall mean fifty percent or more of the voting power or twenty-five percent or more of the assets of the corporation, partnership or joint-venture.

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21. Integration. This Contract constitutes the entire agreement between the parties concerning the subject matter hereof and supersedes any previous oral or written agreement; provided, however, that correspondence or documents exchanged between Contractor and City may be used to assist in the interpretation of the Exhibits to this Contract.
22. Modifications and Amendments. This Contract may be modified or amended only by a change order or Contract Amendment executed by both parties and approved as to form by the City Attorney.
23. Conflicting Provisions. In the event of a conflict between these General Conditions and those of any Exhibit or attachment hereto, these General Conditions shall prevail; provided, however, that any Special Conditions as set forth in Exhibit E shall prevail over these General Conditions. In the event of a conflict between the terms and conditions of any two or more Exhibits or attachments hereto, those prepared by City shall prevail over those prepared by the Contractor, and the terms and conditions preferred by the City shall prevail over those preferred by the Contractor.
24. Non-exclusivity. Notwithstanding any provision herein to the contrary, the services provided by Contractor hereunder shall be non-exclusive, and City reserves the right to employ other Contractors in connection with the project.
25. Exhibits. All Exhibits hereto are made a part hereof and incorporated herein by reference; provided, however, that any language in Exhibit A which does not pertain to the project description, proposal, scope of services, or method of compensation (as applicable), or any corresponding responsibilities of City, shall be deemed extraneous to, and not a part of, this Contract.
26. Force Majeure. Neither party hereto shall be considered in default in the performance of its obligations hereunder to the extent that the performance of such an obligation is prevented or delayed by reason of acts of God, strikes, boycotts, lock-outs, inability to procure materials not related to the price thereof, failure of power, restrictive governmental laws and regulations enacted after the date of this Contract, riots, civil unrest, acts of terrorism, insurrection, war, declaration of a state or national emergency or other reasons of a like nature not within the reasonable control of such party.
27. Time of the Essence. Time is of the essence of this Contract. Contractor and City agree that any time period set forth in Exhibit A represents their best estimates with respect to completion dates and both Contractor and City acknowledge that departures from the schedule may occur. Therefore, both Contractor and City will use reasonable efforts to notify one another of changes to the schedule. Contractor shall not be responsible for performance delays caused by others, or delays beyond Contractor's control, and such delays shall extend the times for performance of Contractor's work.
28. Confidentiality. Contractor agrees to comply with, and to require its employees, agents and partners to comply with, all applicable State or Federal statutes or regulations respecting confidentiality, including but not limited to, the identity of persons served under this Contract,

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their records, or services provided them, and assures that:

All applications and records concerning any individual made or kept by Contractor or any public officer or agency in connection with the administration of or relating to services provided under this Contract will be confidential, and will not be open to examination for any purposes not directly connected with the administration of such service.

No person will publish or disclose or permit or cause to be published or disclosed, any list of persons receiving services, except as may be required in the administration of such service.

29. Third Parties. Nothing herein shall be interpreted as creating any rights or benefits in any third parties. For purposes hereof, transferees or assignees as permitted under this Contract shall not be considered "third parties."
30. Governing Law. This Contract shall be construed in accordance with the law of the State of California without regard to principles of conflicts of law. This Contract is made in Contra Costa County, California, and any action relating to this Contract shall be instituted and prosecuted in the courts of Contra Costa County, California.
31. Nonrenewal. Contractor understands and agrees that there is no representation, implication, or understanding that the services provided by Contractor under this Contract will be purchased or renewed by the City under a new contract following expiration or termination of this Contract, and waives all rights or claims to notice or hearing respecting any failure by City to continue the purchase of all or any failure to continue purchase of all or any such services from Contractor.
32. Claims. Any claim by Contractor against City hereunder shall be subject to Government Code §§ 800 et seq. The claims presentation provisions of said Act are hereby modified such that the presentation of all claims hereunder to the City shall be waived if not made within six months after accrual of the cause of action.
33. Interpretation. This Contract shall be interpreted as if drafted by both parties.
34. Warranty. In the event that any product shall be provided to the City as part of this Contract, Contractor warrants as follows: Contractor possesses good title to the product and the right to transfer the product to City; the product shall be delivered to the City free from any security interest or other lien; the product meets any specifications contained herein; the product shall be free from material defects in materials and workmanship under normal use for a period of one (1) year from the date of delivery; and the product shall be fit for its intended purpose(s). Notwithstanding the foregoing, consumable and maintenance items (such as light bulbs and batteries) shall be warranted for a period of one hundred and eighty (180) days from the date of delivery. All repairs during the warranty period shall be promptly performed by Contractor, at Contractor's expense, including shipping.

For the Contract between the City of  
Richmond Rent Board and

**KENNETH BAAR**

35. **Severability.** In the event that any of the provisions or portions or applications thereof of this Contract are held to be unenforceable or invalid by any court of competent jurisdiction, City and Contractor shall negotiate an equitable adjustment in the provisions of the Contract with a view toward effecting the purpose of this Contract, and the validity and enforceability of the remaining provisions or portions or applications thereof, shall not be affected thereby.
36. **Authority.** City warrants and represents that the signatory hereto (the Mayor of the City of Richmond or the City Manager) is duly authorized to enter into and execute this Contract on behalf of City. The party signing on behalf of Contractor warrants and represents that he or she is duly authorized to enter into and execute this Contract on behalf of Contractor, and shall be personally liable to City if he or she is not duly authorized to enter into and execute this Contract on behalf of Contractor.
37. **Waiver.** The waiver by City of any breach of any term or provision of this Contract shall not be construed as a waiver of any subsequent breach. Inspections or approvals, or statements by any officer, agent or employee of the City relating to the Contractor's performance, or payments therefore, or any combination of these acts, shall not relieve the Contractor's obligation to fulfill this Contract as prescribed; nor shall the City be thereby stopped from bringing any action for damages or enforcement arising from any failure to comply with any of the terms and conditions of this Contract.
38. **Possessory Interest.** If this Contract results in the Contractor having possession of, claim to or right to the possession of land or improvements, but does not vest ownership of the land or improvements in the same person, or if this Contract results in the placement of taxable improvements on tax exempt land (Revenue and Taxation Code 107), such interest or improvements may represent a possessory interest subject to property tax, and Contractor may be subject to the payment of property taxes levied on such interest.
39. **Performance and Final Acceptance.**

Contractor represents that it is experienced, qualified, registered, licensed, equipped, organized and financed to perform the services under this Contract.

Contractor shall perform the services under this Contract with that degree of skill and judgment normally exercised by professional firms performing services of a similar nature in the State of California, and shall be responsible for the professional quality, technical accuracy and coordination of the services it performs under this Contract. In addition to the other rights and remedies which City may have, Contractor shall, at its own expense, correct any services which fail to meet the above standard.

City shall provide Contractor an opportunity to cure errors and omission which may be disclosed during the review of submittals, with no increase in the authorized Contract Payment Limit. Should Contractor fail to make necessary corrections in a timely manner, such corrections shall be made by the City and the cost thereof shall be charged to Contractor.

**ITEM F-3  
ATTACHMENT 2**

For the Contract between the City of  
Richmond Rent Board and

**KENNETH BAAR**

If warranted, City shall determine, and Contractor may request such determination, that Contractor has satisfactorily completed performance of this Contract. Upon such determination, City shall issue to Contractor a written Notice of Final Acceptance, after which Contractor shall not incur further costs under this Contract. Contractor shall respond to such Notice of Final Acceptance by executing and submitting to City a Release and Certificate of Final Payment.

40. Survival. The rights and obligations of the parties which by their nature survive termination or completion of the services covered by this Contract shall remain in full force and effect after termination or completion.

For the Contract between the City of  
Richmond Rent Board and

**KENNETH BAAR**

**EXHIBIT E**  
**SPECIAL CONDITIONS**

The General Conditions are hereby amended to include the following modifications and/or provisions (if applicable):

Insurance requirements modified per Risk Manager on 10/10/17.

City has reviewed Contractor's insurance documents and has deemed that they meet contract conditions.

For the Contract between the City of  
Richmond Rent Board and

**KENNETH BAAR**

**EXHIBIT F  
INSURANCE PROVISIONS**

During the entire term of this Contract and any extension or modification thereof, the CONTRACTOR shall keep in effect insurance policies meeting the insurance requirements specified in the insurance provisions which are attached hereto and incorporated herein by this reference.

**SEE MODIFIED INSURANCE REQUIREMENTS APPROVED BY RISK MANAGER  
10/10/17.**



City of Richmond  
**Sole Source Justification**

**THIS FORM MUST BE COMPLETED AND APPROVED PRIOR TO ANY PURCHASE**

**Contact the Purchasing Division and discuss your rationale before completing this form. If Purchasing can help you make this a competitive purchase, then this form will not be required.**

Attach this completed/approved form to requisitions when competitive quotes/bids/proposals are not solicited. (Required for requisitions > \$3,000)

**Requested Sole Source Supplier:**

Company Name: Ken Baar Contact Name: Ken Baar

Address: 17 Katrine Street

City: West End State: Queensland Zip Code: 4101 Australia

Phone Number (510) 717-2025 E-Mail kenbaar@aol.com

Duration of Contract: August 28, 2017- June 30, 2018

Estimated Cost: \$ 30,000 Funding Source (Account String) 11850065 400201

Is the product/service IT related? Yes  No  If Yes, please attach the approved IT Authorization Form

For Product: Is the recommended company the manufacturer of the product? Yes  No

For Product: Does the manufacturer sell the item(s) through distributors? Yes  No

**Description of Product or Service:**

*Describe the full scope of work or service contemplated including installation if required; items should include brand, model and part number if applicable; (if additional space is needed, include them in a separate page)*

Prepare a proposed regulation, memorandum, and agenda report on Fair Return standards as described in the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance. Prepare a memo and agenda report on policy and legal alternatives in regard to units with historically low rents. Prepare a memo and agenda report on rent adjustment policies and legal issues in regard to capital improvements. Draft Rent Regulations related to previous mentioned items. Provide Comments on Other Policy and Legal Issues as Agreed to By Consultant and Executive Director or assigned staff.

**Sole Source Rationale:** PLEASE ANSWER ALL THE FOLLOWING QUESTIONS: Explain why the recommended company is the only company that can meet the requirement. Address the following: Are there any other companies who can do this job? What condition (e.g. technological superiority, or performance risks, etc.) exists so that the recommended company has a significant advantage over any other company who can do this job? It is important to sufficiently address the key reason for awarding an order/contract without soliciting competitive bids. The rationale must be clear and convincing, avoiding generalities and unsupported conclusions.

Ken Baar is the subject matter expert on Fair Return standards, not just in California, but nationally and internationally. Mr. Baar has written rent regulations for many rent control jurisdictions in California and is an expert at drafting Fair Return regulations. Ken Baar is the only contractor who will be able to prepare such regulations in a legally defensible manner. Because there is currently a backlog of over 40 landlord Fair Return petitions and there are no Fair Return regulations yet in place, those petitions cannot yet be adjudicated, placing the City at substantial legal risk. Please see attached email to Belinda Warner, Finance Director, dated September 7, 2017, for additional detail.

*(if additional space is needed, include them in a separate page)*

**Complete the following checklist**

A specific contractor is the only source of the required item because (check all that apply):

- The required items are **proprietary to the Contractor**, and contractor solely transacts (sells) direct to the customer. (There are no dealers or distributors for contractor).
- The required items are **proprietary to the Contractor**, and **contractor does not sell direct to the customer**. Contractor solely distributes the item or service through only one dealer or distributor in the United States. (There are no dealers or distributors for contractor).

**Note:** If item or service is available from more than one source, the item or service may be treated as proprietary, but must be competitively solicited from multiple (two or more) sources.

- A specific item is needed:
  - To be compatible or interchangeable with existing hardware
  - As spare or replacement hardware     For the repair or modification of existing hardware
- Federal or state grant names vendor as condition of funding. (Attach copy of grant that names vendor)
- There is a **substantial risk** in contracting with any other contractor, (e.g., only one contractor has been successful to date in implementing a difficult manufacturing process or the **services sought**). ***In a brief explanation, provide supporting evidence of why other contractors are considered to be unable to overcome the substantial risk.***

The Richmond Rent Program must create rent regulations related to upward or downward rent adjustments in order to hear rent increase and rent decrease petitions. In particular, the Fair Return regulations must be created to allow landlords to have a process by which they can petition for a rent increase resulting from not receiving a Fair Return. Ken Baar is an internationally respected expert in rent control laws, and in particular, in Fair Return regulations and policies. Ken Baar is the only contractor with the necessary level of expertise in the subject area. If the Rent Program contracts with someone who is less knowledgeable than Ken Baar, it runs the risk of drafting inferior regulations that may cost the Program and the City unnecessary expense in the future, trying to correct the deficiencies in those regulations. See attached email to Belinda Warner, Finance Director, dated September 7, 2017, for additional detail.

- Continuation of prior Work** – Additional item, service or work required, but not known to have been needed when the original order was placed with vendor, and it is not feasible or practicable to contract separately for the additional need. ***Provide brief explanation and supporting evidence.***

*(if additional space is needed, include them in a separate page)*

**ITEM F-3**  
**ATTACHMENT 3**

I acknowledge the City's requirements for soliciting competitive quotes/bids for purchases over \$3,000.00 and the criteria for justification for Sole Source purchases. I have gathered the required information, have made a concerted effort to review comparable/equal equipment/services (e.g., market research), and further affirm that there is no conflict of interest involved in the selection made.

Department: Rent Program

Requester Name and Title: Nicolas Traylor

Date: 02-05-2018

*Note: Requester must be able to defend this justification.*

Phone: (510) 620-6564

Department Director (Print) Nicolas Traylor (Sign) \_\_\_\_\_ Date: \_\_\_\_\_

-----  
**Submit completed form to the Purchasing Division (Prior to submission to Executive Director)**

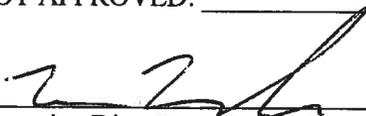
**Finance Director:**

APPROVED: \_\_\_\_\_

DATE: \_\_\_/\_\_\_/\_\_\_

NOT APPROVED: \_\_\_\_\_

COMMENTS: \_\_\_\_\_

  
\_\_\_\_\_  
Executive Director

\_\_\_\_\_  
Board Clerk Attesting to Rent Board Approval  
(Over \$10,000.00) (Copy of Minutes may be substituted)

(Under \$10,000.00)

**PROCEDURE**

Sole Source purchase/service are exceptions to the normal bidding process and require a detailed justification. In processing Sole Source requests for supplies, services and/or equipment, the Purchasing Division adheres to and is governed by the principles set forth in City of Richmond Municipal Code Section 2.52.326 Sole Source Procurement.

If you are requesting a particular vendor, brand or product, you must make this fact clear on your Sole Source form. Your request will then be restrictive and non-competitive, and will fall into a sole source category. If the sole source justification is approved, the requisition can be expedited without the normal bidding requirements.

Such a request should not be made unless you are confident that your request is reasonable and appropriately justified to meet the City's requirements and withstand any possible audit. The City's requirements and the format for submitting such requests are contained herein. Sole Source form must be signed by authorized department representative(s). The certification will remain on file for audit purposes.

The following factors **DO NOT** apply to sole source requests and should not be included in your sole source justification. They will not be considered and only tend to confuse the evaluation process.

1. Personal preference for product or vendor.
2. Cost, vendor performance, and local service (these are generally considered award factors in competitive bidding).
3. Features which exceed the minimum department requirements.

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# AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: February 28, 2018

Final Decision Date Deadline: February 28, 2018

**STATEMENT OF THE ISSUE:** At their February 21, 2018, Regular Meeting, Rent Boardmembers received a draft proposed Maintenance of Net Operating Income Fair Return Regulation (Chapter 9). Given the complexity and impact of this regulation, and considering feedback received from members of the Rent Board and community groups, staff members recommend that Boardmembers continue to discuss and consider the application of a Maintenance of Net Operating Income Fair Return Regulation to ensure there is adequate understanding of the proposed regulation prior to its adoption and the Board's consideration of Historically Low Rent and Capital Improvement regulations.

## 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

- |   |  |  |
|---|--|--|
| <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>STUDY AND ACTION SESSION</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 a presentation concerning application of the proposed draft Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9) and PROVIDE direction to staff - Rent Program (Nicolas Traylor/Michael Roush 620-6564).

AGENDA ITEM NO:

**G-1.**

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# AGENDA REPORT

**DATE:** February 28, 2018

**TO:** Chair Gray and Members of the Rent Board

**FROM:** Nicolas Traylor, Executive Director  
Michael Roush, Legal Counsel

**SUBJECT:** PRESENTATION REGARDING APPLICATION OF A PROPOSED MAINTENANCE OF NET OPERATING INCOME (MNOI) FAIR RETURN REGULATION (Chapter 9)

## **STATEMENT OF THE ISSUE:**

At their February 21, 2018, Regular Meeting, Rent Boardmembers received a draft proposed Maintenance of Net Operating Income Fair Return Regulation (Chapter 9). Given the complexity and impact of this regulation, and considering feedback received from members of the Rent Board and community groups, staff members recommend that Boardmembers continue to discuss and consider the application of a Maintenance of Net Operating Income Fair Return Regulation to ensure there is adequate understanding of the proposed regulation prior to its adoption and the Board's consideration of Historically Low Rent and Capital Improvement regulations.

## **RECOMMENDED ACTION:**

RECEIVE a presentation concerning application of the proposed draft Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9) and PROVIDE direction to staff (Nicolas Traylor/Michael Roush 620-6564).

## **FISCAL IMPACT:**

There is no fiscal impact related to this item.

## **DISCUSSION:**

### Background

For most multi-family rental properties in the City of Richmond, rent increases are limited to the annual change in the Consumer Price Index (a measure of inflation). The Richmond Fair Rent, Just Cause for Eviction and Homeowner Protection Ordinance

440 Civic Center Plaza, Richmond, CA 94804-1630  
Telephone: (510) 620-6576 Fax: (510) 307-8149 [www.richmondrent.org](http://www.richmondrent.org)

## ITEM G-1

provides Landlords with the right to a reasonable return on their rental property investment and tasks the Rent Board with promulgating “Fair Return” standards and regulations.

At their meeting on December 20, 2017, the Rent Board received a memorandum from Kenneth Baar regarding the Maintenance of Net Operating Income (MNOI) fair return standard and directed staff to prepare implementing regulations utilizing the MNOI standard (Attachment 1). Accordingly, at their meeting on February 21, 2018, Boardmembers received and considered a subsequent memorandum and draft proposed regulation for allowing adjustments in the Maximum Allowable Rent to ensure Landlords are able to receive a fair return on their rental property investment (Attachment 2). In the proposed regulation, “Fair Return” is defined as the right to obtain a net operating income equal to the base year net operating income adjusted by a set percentage increase in the Consumer Price Index (CPI), since the base year (Attachment 3).

### Recommended Approach

Due to the complexity and impact of a Fair Return Regulation, staff members believe it is prudent for the Rent Board to continue to discuss and consider the proposed regulation prior to adoption. In addition, staff members intend to provide the Board and members of the community with an opportunity to achieve a thorough understanding of the Maintenance of Net Operating Income regulation prior to consideration of Historically Low Rent or Capital Improvement regulations.

### Community Engagement

On December 4 and December 9, 2017, Rent Program staff members hosted two well-attended community workshops regarding setting standards in the Maximum Allowable Rent. Relevant portions of the community workshop presentation and community feedback summaries are contained in Attachment 4 of this item.

A proposed draft Fair Return Regulation (Chapter 9) was posted on the Rent Program website on February 14, 2018, and a listserv message was sent with instructions for submitting comments prior to the February 28, 2018 Board meeting.

Updates regarding the process of developing Rent Adjustment Regulations will be posted at <http://www.ci.richmond.ca.us/3521/Rent-Adjustment-Regulations> and disseminated via the Rent Program listserv.

## ITEM G-1

### Proposed Timeline and Next Steps

<b>Proposed Date</b>	<b>Event</b>
February 28, 2018- Special Rent Board Meeting	Rent Board continues discussion regarding MNOI Fair Return regulation (Chapter 9)
March 21, 2018 – Regular Rent Board Meeting	Rent Board considers adoption of Fair Return regulation (Chapter 9) and receives Historically Low Rent and Capital Improvement regulations
Late March/Early April 2018	First Rent Adjustment Petition hearings are scheduled
April 18, 2018 – Regular Rent Board Meeting	Rent Board considers adoption of Historically Low Rent and Capital Improvement regulations

### **DOCUMENTS ATTACHED:**

Attachment 1 – December 20, 2017, Memorandum from Ken Baar concerning Fair Return Rent Adjustment Standards

Attachment 2 – February 21, 2018, Memorandum from Ken Baar concerning the proposed Maintenance of Net Operating Income

Attachment 3 – Proposed Draft Fair Return (MNOI) Regulations (Chapter 9)

Attachment 4 – Community Workshop presentation and community feedback concerning fair return standards

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MEMORANDUM

**TO:** Chair Gray and Members of the Rent Board  
**FROM:** Kenneth Baar, Consultant<sup>1</sup>  
**DATE:** December 20, 2017  
**SUBJECT:** FAIR RETURN METHODOLOGIES

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*Executive Summary*

This memo discusses fair return concepts and makes recommendations to the Rent Board for the selection of a fair return standard.

Richmond's "Fair Rent, Just Cause for Eviction and Homeowner Protection Ordinance" provides for a right to a fair return ("a Reasonable Return on ... Investment") and includes a list of factors to be considered in individual rent adjustment cases. However, it does not provide a methodology or standard for or calculating fair return.

The State Supreme Court has held that an ordinance with a list of factors, but without a specific fair return standard is constitutional. Also, the Courts have held that no single type of fair return formula is required. Instead, "a governmental entity may choose to regulate pursuant to any fairly constructed formula. While the selection of a fair return standard is a legislative task, the Courts are the ultimate arbiters of whether a particular standard or the application of the standard in a rent adjustment case permits a fair return. It is strongly recommended that the Rent Board adopt a specific standard to provide guidance to tenants, landlords and hearing officers and ensure consistency in decisions. In the absence of specific standards, fair return hearings commonly turn into legislative type hearings over what standard shall be used as well determinations of what rent increase is justified under the standard.

**Maintenance of Net Operating Income (MNOI) Standard**

Most jurisdictions with apartment rent controls (including Los Angeles and San Jose) have adopted a maintenance of net operating income (MNOI) fair return standard. "Net operating income" is rental income net of operating expenses. Mortgage interest is not considered an operating expense. In the apartment rental business typically 30 to 50% of rental income covers operating expenses and the balance is net operating income, which covers mortgage payments and provides cash flow.

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<sup>1</sup> Baar's publications and testimony on fair return issues have been cited frequently in published California appellate courts opinions. He has prepared fair return reports for 18 California jurisdictions in fair return cases.

## ITEM G-1 ATTACHMENT 1

Under the MNOI standard, current year net operating income is compared with base year net operating income. "Fair return" is defined as base year net operating income adjusted by the percentage increase in the Consumer Price Index (CPI) since the base year or a portion of the percentage increase in the CPI since the base year. The amortized costs of capital improvement expenses are included as operating expenses. To the extent that reasonable increases in maintenance costs are not covered and growth in net operating income is not provided by annual allowable increases, the MNOI provides for the recovery of these increases.

For example, under a standard which provides for indexing the net operating income at 100% of the rate of increase in the CPI, if the net operating income was \$100,000 in the base year and the CPI has increased by 70% since the base year, the current fair net operating income would be \$170,000.

### **Fair Rate of Return on Investment Standard**

A second type of fair return standard is a "rate of return on investment" (ROI) standard. Under that standard, a fair return is a net operating income equal to a designated percentage of the investment.

$$\text{FAIR RENT} = \text{OPERATING EXPENSES} + X\% \text{ of INVESTMENT}$$

From an intuitive perspective a rate of return of investment standard is often viewed as very logical. Richmond's ordinance includes a provision stating that one of its purposes is to provide a fair "return on investment." (Sec. 11.100.070 (g)(8)). This type of provision is common among rent stabilization ordinances. However, none of the jurisdictions with apartment rent controls use a rate of return on investment standard.

Rate of return on investment is commonly used as a measure of return by real estate analysts in evaluating real estate investments and is based on the commonly accepted concept that investors should always be permitted a fair rate of return on their investments. However, in the context of a fair return determination under a rent regulation, the use of a fair rate of return on investment standard in rent regulation works in a **circular** manner.

In the market place, investment is determined by the expected returns. If the allowable returns in a rent-regulated environment are set at designated percentage of the amount invested in a property, the process of determining what is a fair return becomes circular. Under this type of standard, the investment (and, therefore, the investor) determines what return and, therefore, what rents will be fair. Apart from this conceptual defect, rates of return vary substantially among properties and experts have widely diverging opinions about what rate is fair.

### **A Standard Providing for Rent Adjustments Based on Increases in Operating Expenses over the Prior Year**

A third methodology for setting allowable rents pursuant to individual rent adjustments provides for rent increases to cover operating cost increases since the prior year, which are not covered by the allowable annual rent increase. This type of standard is in effect under San

## ITEM G-1 ATTACHMENT 1

Francisco rent regulations. San Jose had this type of standard until it was replaced by an MNOI standard in 2017.

A concern about this type of standard is that substantial variations in annual maintenance expenses can be typical. This type of standard enables apartment owners to obtain increases due to unusually high operating expenses in a particular year or may reward intentional bunching of maintenance expenses which do not recur annually into a particular year.

### **The Exclusion of Debt Service Costs in Fair Return Standards**

The Richmond ordinance is silent on whether or not debt service costs should be considered.

Eight of the eleven apartment rent control ordinances in California (Los Angeles, San Jose, Oakland, Berkeley, Santa Monica, West Hollywood, East Palo Alto, and Mountain View) specifically **exclude** consideration of debt service in setting allowable rent levels, (except when the debt service is associated with capital improvements).

In three cases, the California Court of Appeal has ruled that a regulation which takes into account debt service and provides for varying allowing rents based on mortgage payments has no rational basis.

### **Recommendation**

It is recommended that the Rent Board adopt regulations that include a specific fair return standard. A fair return standard provides guidance not only to the hearing officer but also to the parties impacted by the Ordinance and provides an objective methodology for consistent decisions.

Furthermore, the adoption of a maintenance of net operating income (MNOI) standard is recommended. The standard guarantees a right to rent increases which cover operating cost increases and provide for growth in net operating income over a base year. The standard has been approved by the courts and in challenges to individual decisions applying the standard, its use has been consistently upheld.

### **I. Introduction**

This memo discusses fair return concepts and makes recommendations to the Rent Board for the selection of a fair return standard.

Under price regulation, including rent control, constitutional property rights include the right to a "fair return." The courts have held legislatures have the power to establish fair return standards. However, the Courts are the ultimate arbiters of what constitutes a fair return. As a consequence, the drafting of fair return standards is strongly guided by judicial precedent.

## **ITEM G-1 ATTACHMENT 1**

Within this framework, rent stabilization ordinances provide for a petition process for adjudicating petitions based on claims that additional rent increases above the allowable annual rent increases and vacancy increases are needed in order to permit a fair return.

Cities with rent stabilization laws (except for a few cities with a small number of units) have adopted a specific method for calculating fair return and allowable rent increases pursuant to individual rent adjustment petitions. These methods are either set forth in the ordinance or in regulations that have been promulgated pursuant to more general fair return requirements in the ordinance.

Richmond's "Fair Rent, Just Cause for Eviction and Homeowner Protection Ordinance" provides for a right to a fair return ("a Reasonable Return on ... Investment") and includes a list of factors to be considered in individual rent adjustment cases. However, it does not provide a method for calculating fair return.

The applicable section states:

### **Landlords Have the Right to a Reasonable Return on Their Investment.**

**In making individual adjustments of the rent ceiling, the Board or hearing examiner shall consider the purposes of this chapter and shall specifically consider all relevant factors, including (but not limited to):**

- (1) Increases or decreases in property taxes;**
- (2) Unavoidable increases or any decreases in maintenance and operating expenses;**
- (3) The cost of planned or completed capital improvements to the rental unit (as distinguished from ordinary repair, replacement and maintenance) where such capital improvements are necessary to bring the property into compliance or maintain compliance with applicable local code requirements affecting health and safety, and where such capital improvement costs are properly amortized over the life of the improvement;**
- (4) Increases or decreases in the number of tenants occupying the rental unit, living space, furniture, furnishings; equipment, or other housing services provided, or occupancy rules;**
- (5) Substantial deterioration of the controlled rental unit other than as a result of normal wear and tear;**
- (6) Failure on the part of the Landlord to provide adequate housing services, or to comply substantially with applicable state rental housing laws, local housing, health and safety codes, or the rental agreement;**
- (7) The pattern of recent rent increases or decreases;**
- (8) It is the intent of this chapter that individual upward adjustments in the rent ceilings on units be made only when the Landlord demonstrates that such adjustments are necessary to provide the landlord with a fair return on investment. (Sec. 11.100.070)**

## ITEM G-1 ATTACHMENT 1

While Richmond's ordinance does not set forth a methodology for calculating fair return or allowable rent increases pursuant to individual rent increase petitions, it states that: "The Board shall issue and follow such rules and regulations, including those which are contained in this Chapter, as will further the purposes of the Chapter." (Sec. 11.100.060 (f)).

Although a list of factors without a specific fair return standard may be constitutional, it is strongly recommended that the Rent Board adopt a specific standard to provide guidance to tenants, landlords and hearing officers and ensure consistency in decisions. In the absence of specific standards, fair return hearings commonly turn into legislative type hearings over what standard shall be used as well determinations of what rent increase is justified under a particular standard.

### II. Alternate Fair Return Methodologies

#### A. Judicial Guidance - General Directions Regarding Fair Return

Since rent regulations became widespread in California at the end of the 1970's and early 1980's fair return has been extensively litigated. Some of the cases have involved facial challenges to ordinances or regulations; however, most have involved challenges to individual rent board decisions in fair return cases. While most of the challenges have been to individual decisions commonly they have raised general issues about what methodologies are valid in making fair return determinations.

Since the mid-1980's, most of the cases have involved regulations of mobilehome park space rents. However, apartment and mobilehome park space rent regulations are guided by the same judicial doctrines and precedents regarding fair return.

The Courts have held that no single type of fair return formula is required.<sup>2</sup> Instead, "a governmental entity may choose to regulate pursuant to any fairly constructed formula."<sup>3</sup> The California Supreme Court has also held that a rent regulation does not have to include a specific method for calculating fair return.<sup>4</sup>

Some of the judicial guidance has been very general. In one case a court explained that fair return involves a "balancing...of investor and...consumer interests" and allowing for rents adequate to "maintain financial integrity."

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<sup>2</sup> *Carson Mobilehome Park Owners' Assn. v. City of Carson*, 35 Cal.3d 184, 191 (1983)

<sup>3</sup> *Carson Harbor Village, Ltd. Carson Mobilehome Park Rent Review Board* (1999) 70 Cal. App. 4<sup>th</sup> 281, 290.

<sup>4</sup> In 1983, in *Carson Mobilehome Park Owners' Assn. v. City of Carson*, the California Supreme Court rejected a claim that a fair return standard in a rent control ordinance which left the selection of a fair return standard open ended and did not prescribe the use of a particular formula was overly vague. The Court stated: That the ordinance does not articulate a formula for determining just what constitutes a just and reasonable return does not make it unconstitutional.

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“Determining prices that will provide a fair return “involves a balancing of the investor and the consumer interests” [cite omitted]. ... One of these investor interests is a “return ... commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover should be sufficient to ... attract capital.” ... a “court must determine whether the [regulation] may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection for the relevant public interests, both existing and foreseeable.”<sup>5</sup>

The California Supreme Court has held that fair return is a “constitutional minimum” and the fact that a regulation reduces the value of a property does not render it unconstitutional.<sup>6</sup>

In *Galland v. Clovis*, the California Supreme Court stated:

“Although the term “fair rate of return” borrows from the terminology of economics and finance, it is as used in this context a legal, constitutional term. It refers to a constitutional minimum within a broad zone of reasonableness. As explained above, within this broad zone, the rate regulator is balancing the interests of investors, i.e. landlords, with the interests of consumers, i.e. mobilehome owners, in order to achieve a rent level that will on the one hand maintain the affordability of the mobilehome park and on the other hand allow the landlord to continue to operate successfully. [cite omitted]. For those price-regulated investments that fall above the constitutional minimum, but are nonetheless disappointing to investor expectations, the solution is not constitutional litigation but, as with nonregulated investments, the liquidation of the investments and the transfer of capital to more lucrative enterprises.”<sup>7</sup>

Another California Supreme Court opinion notes:

“[a]ny price-setting regulation, like most other police power regulations of property rights, has the inevitable effect of reducing the value of regulated properties. But it has long been held that such reduction in property value does not by itself rend a regulation unconstitutional.”<sup>8</sup>

The Courts have repeatedly reiterated the principle that a “range” of rents may be considered reasonable. One court explained:

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<sup>5</sup> *Galland v. City of Clovis*, 24 Cal. 4<sup>th</sup> 1003 (2001), *Kavanau v. Santa Monica Rent Control Board*, 16 Cal.4<sup>th</sup> 761, 771-772 (1997).

<sup>6</sup> Other types of land use regulations such as zoning amendments commonly reduce property values.

<sup>7</sup> *Galland v. City of Clovis*, 24 Cal.4<sup>th</sup> 1003, 1026 (2001)

<sup>8</sup> *Fisher v City of Berkeley*, 37 Cal.3d. at 686.

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There is a range of rents which can be charged, all of which could be characterized as allowing a "just and reasonable" return. [cite omitted] [the terms "just and reasonable" and "confiscatory" are not precise formulations]; [cite omitted] [there is a zone of reasonableness which is higher than a confiscatory rate].) Thus, many decisions by rent control boards will focus on the issue of where the requested increases fall within the range of possible rents -- all of which rents would allow the owner a return sufficiently "just and reasonable" as to not be constitutionally confiscatory.<sup>9</sup>

The debate over what constitutes a fair return has been complicated by the fact the Courts have reached conflicting conclusions on fair return issues at times and the decisions contain some very general statements open to multiple interpretations.

One California Court of Appeal commented about the complexity of fair return issues and the lack of precision and sometimes conflicting nature of judicial guidance on the issues.

"What appears at first blush to be a simple question of substantial evidence turns out to be something considerably more complex when one realizes that the formula for determining a 'fair return' is hotly debated in economic circles and has been the subject of sparse, scattered, and sometimes conflicting comment by appellate courts. In particular, only the broad outlines have been discussed in California decisions."<sup>10</sup>

### *B. "Specific" Judicial Guidance*

Apart from setting forth general principles about what constitutes a fair return, in the past few decades, there has been substantial precedent in regard to particular types of fair return concepts and standards that have either been commonly advocated and/or adopted.

### **The Courts Have Held that Return on "Value" Standards are Not Required and Are Circular in the Context of Rent Regulation**

In response to fair return claims made in the early 1980s, the Courts rejected the view that a fair *rate* of return on the *value* of a regulated property must be permitted in order to provide a fair return. The Courts have concluded that this type of standard is "circular" in the context of a rent regulation. In 1984, the State Supreme Court explained:

"The fatal flaw in the return on value standard is that income property most commonly is valued through capitalization of its income. Thus, the

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<sup>9</sup> *San Marcos Mobilehome Park Owners' Ass'n v. City of San Marcos*, 192 Cal.App.3d. 1492, 1502-1503 (1987)

<sup>10</sup> *Palomar Mobilehome Park Assn. v. Mobile Home Rent Review Com.* 16 Cal.App.4th 481, 484 (1993).

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process of making individual rent adjustments on the basis of a return on value standard is meaningless because it is inevitably circular: value is determined by rental income, the amount of which is in turn set according to value. Use of a return on value standard would thoroughly undermine rent control, since the use of uncontrolled income potential to determine value would result in the same rents as those which would be charged in the absence of regulation. Value (and hence rents) would increase in a never-ending spiral."<sup>11</sup>

### **The Right to an Increasing Net Operating Income**

Other guidance from the court has come to play a central role in fair return doctrine. One guiding principal is that growth in net operating income (NOI) must be permitted. In *Fisher v. Berkeley* (1984), the State Supreme Court held that a regulatory scheme "may not indefinitely freeze the dollar amount...profits without eventually causing confiscatory results. ...If the net operating profit of a landlord continues to be the *identical* number of dollars, there is in time a real diminution to the landlord which eventually becomes confiscatory."<sup>12</sup> In other words, allowable rent increases must be adequate to cover increases in operating costs and permit growth in net operating income.

In the apartment rental business typically 30 to 50% of rental income covers operating expenses and the balance is net operating income, which covers mortgage payments and provides cash flow.

**Comment on Alternate Standards:** The following discussion addresses conceptual issues and judicial precedent associated with three types of fair return standards. – 1) maintenance of net operating income (MNOI), 2) rate of return on investment (ROI) , and 3) a pass-through of increases in operating costs over the level of the prior year. This section also includes a discussion of judicial precedent regarding consideration of debt service, which indicates that debt service may not be considered in setting allowable rents.

#### **C. Maintenance of Net Operating Income "MNOI" Standard**

##### **a. The MNOI Standard Is the Most Widely Used Standard**

The most widely adopted fair return standard has been the maintenance of net operating income (MNOI) standard. This standard has been adopted by the following jurisdictions with apartment rent controls: Los Angeles, San Jose, Oakland, Berkeley, Santa Monica, West Hollywood, East Palo Alto and Mountain View. Also, a substantial

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<sup>11</sup> . *Id.* 37 Cal.3d.at 680, fn 33.

<sup>12</sup> *Id.* 37.Cal.3d. at 683.

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number of the mobilehome park rent stabilization ordinances in California include an MNOI standard and this standard is commonly used to make fair return determinations pursuant to mobilehome park space rent stabilization ordinances which list factors to be considered in determining what is a fair return, without setting forth a formula.

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Jurisdiction	Type of Fair Return Standard (MNOI = maintenance of net operating income)
<b>Berkeley</b>	MNOI, adopted by regulation
<b>East Palo Alto</b>	MNOI, in ordinance
<b>Santa Monica</b>	MNOI, adopted by regulation
<b>Los Angeles</b>	MNOI adopted by regulation
<b>West Hollywood</b>	MNOI in ordinance
<b>Alameda</b>	list of factors, no specific standard
<b>Oakland</b>	MNOI and pass-through of cost increases over prior year
<b>San Jose</b>	MNOI, in ordinance
<b>San Francisco</b>	increase in costs over prior year
<b>Beverly Hills</b>	MNOI, in ordinance
<b>Mountain View</b>	MNOI, adopted by regulation
<b>Los Gatos</b>	consider increases in operating costs and debt service, no specific standard
<b>Hayward</b>	list of factors, no specific standard, limited pass-through increases in debt service

**b. Description of the Maintenance of Net Operating Income Standard**

This method is not an “intuitive” measure because it is not the measure that investors or laypersons commonly use to measure rate of return. Under the MNOI standard, current year net operating income is compared with base year net operating income. “Fair return” is defined as base year net operating income adjusted by the percentage increase in the Consumer Price Index (CPI) since the base year or a portion of the percentage increase in the CPI since the base year.

For example, under a standard which provides for indexing the net operating income at 100% of the rate of increase in the CPI, if the net operating income was \$100,000 in the base year and the CPI has increased by 70% since the base year, the current fair net operating income would be \$170,000. Under most MNOI standards, the year specified as the base year precedes the adoption of rent regulation.

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The hypothetical example below illustrates how an MNOI standard works, under a standard which defines a fair return as the base period net operating income adjusted by 100% of the percentage increase in the NOI since the base year

In this example, the gross income increased by \$50,000. The net operating income increased from \$60,000 in the base year to \$80,000 in the current year, a 33% increase, compared to a 50% increase in the CPI during this period. This amount would be adequate to cover operating cost increases, but would not provide adequate growth in net operating income. Through an individual rent adjustment petition (with adequate documentation of income and operating expenses) the owner would be able to obtain an additional rent increase. The allowable increase would be \$10,000 in order to raise the net operating income to a level that is 50% above the base year net operating income.

**(Table 1)  
Illustration of MNOI Standard**

	<b>CPI</b>	<b>Gross Income</b>	<b>Operating Expenses</b>	<b>Net Operating Income</b>	<b>Fair Return Allowable Rent Increase</b>
<b>Base Year</b>	<b>100</b>	<b>\$100,000</b>	<b>\$40,000</b>	<b>\$60,000</b>	
<b>Current Year</b>	<b>150</b>	<b>\$150,000</b>	<b>\$70,000</b>	<b>\$80,000</b>	
<b>Pct. Increase Base Year to Current Year</b>	<b>50%</b>	<b>50%</b>	<b>75%</b>	<b>33%</b>	
<b>Fair NOI (Base Year NOI Adjusted by the 50% increase in CPI)</b>				<b>\$90,000</b>	
<b>Allowable Fair Return Rent Adjustment (= Fair NOI - Current NOI) (\$90,000 - \$80,000)</b>					<b>\$10,000</b>

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Jurisdictions with MNOI standards provide for adjusting (“indexing”) base period of net operating income by varying percentages of the percentage increase in the Consumer Price Index, ranging from 40% to 100%. Berkeley and Santa Monica provide for 40% indexing. A majority of mobilehome ordinances provide for indexing by less than 100%. All of these indexing standards have been upheld by the Courts, which have consistently rejected the contention that indexing the net operating income by less than 100% of the percentage increase in the CPI is confiscatory<sup>13</sup>

### c. Rationale for Using the MNOI Standard

To the extent that reasonable increases in maintenance costs are not covered by annual allowable increases, the MNOI provides for the recovery of these increases.

By providing for growth in net operating income, the MNOI standard allows for growth in the portion of rental income (the net operating income) that is available to pay for increases in debt service, to fund capital improvements, and/or to provide additional cash flow (net income). Therefore, the growth in net operating income also provides for appreciation in the value of a property.

The standard provides all owners with the right to an equal rate of growth in NOI regardless of their particular purchase and financing arrangements. By measuring reasonable growth in net operating income by the rate of increase in the CPI, this approach meets the twin objectives of protecting tenants from excessive rent increases that are not justified by operating cost increases and increases in the CPI, and of providing regulated owners with a “fair return on investment.”

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<sup>13</sup> See *Berger v. City of Escondido*, 127 Cal.App.4<sup>th</sup> 1, 13-15 (2007); *Stardust v. City of Ventura*, 147 Cal.App. 4<sup>th</sup> 1170, 1181-1182 (2007); *Colony Cove Properties v. City of Carson*, 220 Cal. App.4<sup>th</sup> 840, 876 (2013) The rationale for less than 100% indexing has been that the rate of increase in equity may exceed 100% of the rate of increase in the CPI even if the rate of increase in the overall value of a property is lower. For example, the value of an apartment building may increase by 20% from \$1,000,000 to \$1,200,000, but the increase in the equity of an owner who purchased with a 70% loan may increase from \$300,000 to \$500,000.

In the Colony Cove opinion, the Court stated:

In *H.N. & Frances C. Berger Foundation v. City of Escondido*, the court explained why 100 percent indexing was not required for a rent controlled mobilehome park to achieve a fair return: "A mobilehome park's operating expenses do not necessarily increase from year to year at the rate of inflation, and . . . a 'general increase at 100% of CPI . . . would be too much if expenses have increased at a lower rate.'" (*H.N. & Frances C. Berger Foundation v. City of Escondido* [cite omitted].) Moreover, "the use of indexing ratios may satisfy the fair return criterion because park owners typically derive a return on their investment not only from income the park produces, but also from an increase in the property's value or equity over time." (*Ibid.*; accord [cite omitted] [explaining that "one reason for indexing NOI at less than 100 percent of the change in the CPI" is that "real estate is often a leveraged investment" in which "[t]he investor invests a small amount of cash, but gets appreciation on 100 percent of the value"]. *Id.*876-877.

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Under the MNOI standard, it becomes the investor's task to determine what investment and financing arrangements make sense in light of the growth in net operating income permitted under the fair return standard.

### d. Judicial Acceptance of the MNOI Standard

California appellate Courts have repeatedly upheld the use of an MNOI standard.<sup>14</sup> For example, one court found the MNOI standard was reasonable because it allowed an owner to maintain prior levels of profit<sup>15</sup>, and another concluded the MNOI formula is a "fairly constructed formula" which provides a "just and reasonable" return on ... investment," even if an alternative fair return standard – such as the rate of return on investment standard (discussed further below) – would provide for a higher rent.<sup>16</sup>

Several California courts have approved the MNOI fair return standard (*Oceanside Mobilehome Park Owners' Ass'n v. City Oceanside*, 157 Cal. App. 3d. 887 (1984). See also *Baker v. City of Santa Monica*, 181 Cal. App. 3d. 972 (1986). California appellate courts upheld maintenance of net operating income fair return standards. In *Oceanside* the Court found that the standard was reasonable because it allowed an owner to maintain prior levels of profit. See 157 Cal. App. 3d. 887, 902-905 (1984). "The maintenance-NOI approach has been praised by commentators for both its fairness and ease of administration." See *Palomar Mobilehome Park Assn. v. Mobile Home Rent Review Com.*, 16 Cal.App.4th 481, 486 (1993)

In *Rainbow Disposal v. Mobilehome Park Rental Review Board*, 64 Cal. App. 4th 1159, 1172 (1998), the Court of Appeal stated: [the] MNOI approach adopted by the Board is a "fairly constructed formula" which provided Rainbow a sufficiently "just and reasonable" return on its investment. The Board was not obliged to reject [an] MNOI analysis just because an historical cost/book value formula using Rainbow's actual cost of acquisition and a 10 percent rate of return would have yielded a higher rent increase.

In 2013, in *Colony Cove v. City of Carson*, the Court explained the rationale for an MNOI standard.

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<sup>14</sup> Most of the published appellate court opinions regarding fair return under rent regulation have involved mobilehome park rent regulations. This is a consequence of the facts that: 1) the mobilehome rent regulations are stricter – not allowing for increases upon vacancies, 2) some of the mobilehome rent ordinances have not allowed for annual across-the-board rent increases, thereby compelling owners to submit fair return petitions each time they desire to obtain a rent increase, 3) the stakes in mobilehome park cases are substantial due to the size of mobilehome parks, typically involving from one to several hundred spaces. However, in regards to fair return issues the fair return concepts are interchangeable with the courts relying on fair return opinions from apartment cases in mobilehome park cases and vice versa.

<sup>15</sup> *Oceanside Mobilehome Park Owners' Ass'n v. City Oceanside*, 157 Cal.App.3d.887 (1984); Also see *Baker v. City of Santa Monica*, 181 Cal.App.3d. 972 (1986)

<sup>16</sup>

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The MNOI approach does not focus on how much the owner chose to pay for a rent-controlled property or how the purchase was financed. That fact does not render it constitutionally invalid. In *Donohue v. Santa Paula West Mobile Home Park*, where the rent control ordinance permitted adjustments to " 'maintain net operating income' " and specifically excluded from consideration " '[m]ortgage principal [and] interest payments,' " the court rejected the owner's facial challenge to the ordinance: "Numerous courts ... have acknowledged that the [MNOI] approach is constitutionally valid ... ," even though it ignores "certain expenses incurred by landlords" in determining NOI, including "land acquisition costs ... ." (*Donohue v. Santa Paula West Mobile Home Park*, supra, 47 Cal.App.4th at p. 1178; see *Rainbow Disposal Co. v. Escondido Mobilehome Rent Review Bd.*, supra, 64 Cal.App.4th at p. 1172 [rent board need not reject MNOI merely because formula using owner's actual cost of acquisition yielded higher rent increase].) Indeed, the MNOI standard has been praised by courts and commentators for "its fairness and ease of administration" (*Palomar Mobilehome Park Assn. v. Mobile Home Rent Review Com.*, supra, 16 Cal.App.4th at p. 486), because it " 'recognizes that in the rental housing market, ratios of rental income to value, equity, and gross income vary substantially among buildings. Therefore, rather than designating a particular rate of return as fair, [MNOI] standards pursue the best available option, which is to preserve prior [net operating income] levels' " (*H.N. & Frances C. Berger Foundation v. City of Escondido* (2005) 127 Cal.App.4th 1, 9 [25 Cal. Rptr. 3d 19]). The advantage of the MNOI approach over other methods of determining fair rent was further explained in *Oceanside Mobilehome Park Owners' Assn. v. City of Oceanside*, where the court stated: " 'Use of a return on value standard would thoroughly undermine 220 Cal. App. 4th 840, \*868; ...rent control, since the use of uncontrolled income potential to determine value would result in the same rents as ... would be charged in the absence of regulation. Value (and hence rents) would increase in a never-ending spiral.' " [cites omitted] ....

Use of the MNOI formula " ' "avoids the necessity of having to undertake the administratively difficult (if not impossible) task of calculating equity and/or fair market value.["] ' " [cite omitted] ... Instead, it "permits park owners to obtain a just and [\*\*\*60] reasonable return under general marketing conditions in any given year" and "reflect[s] the tenant's interest by giving the park owner an incentive to incur all reasonable expenses for maintenance and services." [cite omitted].<sup>17</sup>

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<sup>17</sup> 220 Cal. App. 4<sup>th</sup> 849, 869-870 (2013)

**e. Adjustment of Low Base Year Rents (“Vega” Adjustments) under the MNOI Standard**

If an MNOI standard only permitted consideration of actual base year net operating levels, owners with very low base period rents may be locked into rents that do not reflect market conditions. This would occur because the current fair net operating income under the MNOI standard would be based on a CPI adjustment of a low base period net operating income.

However, this issue has been addressed by authorizing adjustments of base period rent which do not reflect market conditions in order to provide a level that reflects market conditions and provides a reasonable base period net operating income. Such adjustments are known as “Vega” adjustments, because the right to such adjustments was established in the case of *Vega v. West Hollywood*.<sup>18</sup>

The *Vega* case involved an apartment owner who charged rents that ranged from \$70 to \$180 per month, compared to a city average which was three times higher. The rents of several units had not been raised in 15 to 20 years and the tenants had taken over responsibility for maintaining the property, from the 84 year old owner. The Court held the peculiar circumstances in this case, in addition to low base period rents, justified a base period rent adjustment.

The entitlement to an increase in the base rent depends on the existence of circumstances that prevented the base rent from reflecting market conditions.”<sup>19</sup> Subsequent to *Vega*, an appellate court rejected the view that owners had a general entitlement to adjust base date rents which were below market rents and ruled that:

**Respondents' position that "Birkenfeld and Vega establish a constitutional standard of general application to all historically low rent properties without exception" is not supported by the opinions in those cases, and we hold that there is no general entitlement to an increase in base date rents predicated on market conditions.**<sup>20</sup>

In the context of mobilehome park space rent controls the historically low rent issue was considered in *Concord Communities v. City of Concord*,<sup>21</sup> in 2001. In that case the Court found a recent purchaser of the park met the “unique and extraordinary circumstances” test set forth in *Vega* based on the following facts:

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<sup>18</sup> 223 Cal.App.3d 1342 (1990); also, see *Concord Communities v. City of Concord*, 91 Cal. App.4th 1407 (2001)

<sup>19</sup> 24 Cal. App.4th 1730, 1737

<sup>20</sup> *Apartment Association of Greater Los Angeles v. Santa Monica Rent Control Board* [AGLA] 24 Cal. App.4th 1730, 1737.( 1994)

<sup>21</sup> 91 Cal. App.4th 1407 (2001)

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- 1) the applicant was locked into below market rents set by the prior owner, who had “not raised rents in a consequential manner since 1985”,
- 2) the current owner entered into a purchase contract just before the city adopted a rent regulation and
- 3) the current owner was not favored by particularly low property taxes of the previous owner.<sup>22</sup>

**D. Fair Rate of Return on Investment Standard**

A second type of fair return standard is a rate of return on investment (ROI) standard. From an intuitive perspective a rate of return of investment standard is often viewed as very logical. Furthermore, Richmond’s ordinance includes a provision stating that one of its purposes is to provide a fair “return on investment.” (Sec. 11.100.070 (g)(8)). This type of provision is common among rent stabilization ordinances. Sometimes it has sometimes been viewed as commanding the use of a rate of return on investment formula; however, usually this view has not been adopted.

**a. Description of Standard**

In the context of rent regulations, the most common rate of return on investment formula has been:

FAIR RENT = OPERATING EXPENSES + X% of INVESTMENT
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The allowable rent depends on what rate of return is considered fair. The following examples illustrate the outcomes under a 6% and a 9% rate of return on investment standard.

(Table 2)

**Variations in Outcomes under Rate of Return on Investment Standard  
Depending on What Rate is Deemed Fair  
(Hypothetical Investment - \$1.2 million)**

OPERATING EXPENSES		X% OF INVESTMENT (fair net operating income)		FAIR RENT
\$70,000	+	\$72,000 (6% of \$1,200,000)	=	\$142,000
Or				
\$70,000	+	\$108,000 (9% of \$1,200,000)	=	\$178,000

<sup>22</sup> *Id.*, 91 Cal. App.4<sup>th</sup> at 1417-1419.

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Investment is defined as the total investment (purchase price + improvements) rather than only as the cash investment (total investment minus mortgage borrowing). The return is the net operating income (income before mortgage payments), rather than only the cash flow (net operating income left after mortgage payments).<sup>23</sup> The fair net operating income is a net operating income which is a designated percentage of the total investment.

### **b. Use of Fair Rate of Return Standard in other jurisdictions**

None of the California jurisdictions with apartment rent regulations use the “rate of return on investment” standard. However, this type of standard has been used in making fair return determinations in some mobilehome park rent stabilization fair return cases.

### **c. Comment on the Fair Rate of Return on Investment Standard**

#### **i. Circularity Issues**

Rate of return on investment is commonly used as a measure of return by real estate analysts in evaluating real estate investments. and is based on the commonly accepted concept that investors should always be permitted a fair rate of return on their investments. However, in the context of a fair return determination under a rent regulation, the use of a fair rate of return on investment standard in rent regulation works in a **circular** manner.

In the market place, investment is determined by the expected returns. However, if the allowable returns in a rent-regulated environment are set at designated percentage of the amount invested in a property, the process of determining what is a fair return becomes circular. Under this type of standard, the investment (and, therefore, the investor) determines what return and, therefore, what rents will be fair.

A leading utility text identifies potential drawbacks using the investment (purchase price or “transfer cost”) as the measure of investment in order to calculate fair return, in the context of a rent regulation.

Transfer cost does not represent a contribution of capital to public service. Instead, it represents a mere purchase by the present company of

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<sup>23</sup> In some jurisdictions a fair return on cash investment (as opposed to total investment) standard has been used. However, such standards discriminate among owners based on their financing arrangements. In three cases, a California Court of Appeal has ruled that consideration of debt service in a rent setting standard has no rational basis. *Palomar Mobilehome Park Ass’n v. Mobile Home Rent Review Commission* [San Marcos], 16 Cal.App.4th 481, 488 (1993) and *Westwinds Mobilehome Park v. Mobilehome Park Rental Review Board* [Escondido], 30 Cal.App.4th 84, 94 (1994), *Colony Cove v. City of Carson*, 220 Cal.App.4th 840, 871 (2013).

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whatever legal interests in the properties were possessed by the vendor. Even under an original-cost standard of rate control, investors are not compensated for buying utility enterprises from their previous owners any more than they are compensated for the prices at which they may have bought public utility securities on the stock market. Instead, they are compensated for devoting capital to public service. ...

The unfairness, not to say the absurdity, of a uniform rule permitting a transferee of a utility plant to claim his purchase price was noted by Judge Learned Hand ...

The builder who does not sell is confined for his base to his original cost; he who sells can assure the buyer that he may use as a base whatever he pays in good faith. If the builder can persuade the buyer to pay more than the original cost the difference becomes part of the base and the public must pay rates computed upon the excess. Surely this is a most undesirable distinction. (*Niagara Falls Power Company v. Federal Power Commission*, 1943 ...) <sup>24</sup>

This reasoning has not been generally applied in rent control cases. However, federal courts in New York have concluded the return on investment approach does not make sense in the context of land use controls and rent regulation, noting how, the "regulated" investor can, in fact, regulate the allowable return under the rate of return on investment approach by determining the size of the investment. In a zoning case, the Court held:

In addition to being inconsistent with the case law, appellants' [return on investment] approach could lead to unfair results. For example, a focus on reasonable return would distinguish between property owners on the amount of their investments in similar properties (assuming an equal restriction upon the properties under the regulations) favoring those who paid more over those who paid less for their investments. Moreover in certain circumstances, appellants theory "would merely encourage property owners to transfer their property each time its value rose, in order to secure ... that appreciation which could otherwise be taken by the government without compensation..." [cites omitted] <sup>25</sup>

While the California courts have not held that a rate of return on investment standard may not be used they have noted the practical limitations of the rate of return on investment approach In the *Fisher* case, the California Supreme Court

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<sup>24</sup> Bonbright, Danielson, and Kamerschen, *Principles of Public Utility Rates*, 240-241 (1988, Arlington, Virginia, Public Utilities Reports, Inc.)

<sup>25</sup> *Park Avenue Tower Associates v. City of New York*, 746 F.2d. 135, 140 (1984).

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noted that the “mechanical” application of a return on investment standard could produce “confiscatory results in some ...cases” and alternatively in other cases could provide for “windfall” returns for recent investors, who paid high prices:

At the same time that mechanical application of the fair return on investment standard may have the potential to produce confiscatory results in some individual cases [cites omitted] it is also recognized that the that standard has the potential for awarding windfall returns to recent investors whose purchase prices and interest rates are high. If the latter aspect were unregulated, use of the investment standard might defeat the purpose of rent price regulation.<sup>26</sup>

Sometimes a “prudent” investor standard is used to try to rectify the shortcomings of a rate of return on investment standard by limiting what size investments will be considered in measuring what net operating income would be fair. However, under this the results become circular, especially if the investment may be considered “prudent” only if the current rents are already adequate to generate a return that would be considered fair.

Subsequent to the *Fisher* opinion, one Court of Appeal concluded that evaluation of a claim that a purchase cost may be viewed as high (imprudent) presents a “Catch-22.” situation. The Court explained:

... it is a “Catch-22” argument. It posits that a prudent investor will purchase only rent-controlled property for a price which provides a fair rate of return at the then-current (i.e. frozen) rental rates. Having done so, however, the fair market value is frozen ad infinitum because no one should pay more than the frozen rental rate permits; and existing rental rates are likewise frozen, since the investor is already realizing a “fair rate of return”.<sup>27</sup>

The foregoing judicial responses to the issues associated with rate of return on investment standards reflect the outcomes of two sides of a circular concept. On the one hand, there is the view that rate of return on investment standards should not provide windfall returns to recent investors who paid high prices. On the other hand, if a “prudent” investment concept is adopted, an investment may be considered imprudent if the current rents do not yield a fair return on that investment.

### **ii. Subjectivity in Measuring Fair Rate of Return under a Rate of Return on Investment Standard**

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<sup>26</sup> 37 Cal.3d. 644, 691 (1984)

<sup>27</sup> *Westwinds Mobile Home Park v. City of Escondido*, (1994), 30 Cal.App.4th. 84, 93-94.

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Apart from the circularity issues associated with the use of a rate of return on investment standard, the determination of an appropriate rate presents substantial problems.

In fact, rates of return vary substantially among properties, especially in times of significant inflation in property values. Therefore, the net operating income (and, consequently the rent) that will yield a fair return on an investment made decades ago might be a fraction of the rent required to provide the same rate of return on the investment of a recent purchaser.

Varying theories and/or statistical constructions” about how to compute what is a “fair rate” can lead to widely differing outcomes. One commentary, in a textbook on utility rate regulation, even characterizes expert presentations on which particular rate is as “witches brews of statistical elaboration and manipulation”:

“... as we begin sheer disgust to move away from the debacle of valuation, we will probably substitute a new form of Roman holiday – long-drawn-out, costly, confusing, expert contrived presentations, in which the simple directions of the *Hope* and *Bluefield* cases are turned into veritable witches’ brews of statistical elaboration and manipulation.<sup>28</sup>

In mobilehome park rent stabilization fair return cases, expert witness’ projections of a fair rate of return have ranged from 4% to 12% (and even higher). Typically, in recent years, experts on behalf of mobilehome park owners have testified that a rate of return of about 9% is fair, while experts on behalf of cities and/or residents have contended that a fair rate is equal to the prevailing capitalization rate, now about 5 to 6%.<sup>29</sup> Adjudicators’ (retired judges acting as arbitrators, rent commissions, trial courts, and appellate courts) conclusions about what rate is fair have ranged from 5% to 9%.

When rate of return on investment standards are used, a host of options appear for measuring the investment and for the determination of a reasonable rate of return. In an adjudicatory process the fair return determination can turn into a mix and match process, in which alternate measures of investment and of a fair rate are “juggled” in order to obtain a desired result.

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<sup>28</sup> Shepard and Gies, *Utility Regulation, New Directions in Theory and Policy*, 242-243 (1966, New York, Random House)

<sup>29</sup> The prevailing capitalization rate is the net operating income/purchase price rate that new purchasers are obtaining at the outset of their investments. When the purchase price is inflation adjusted in the fair return analysis the fair return also becomes inflation adjusted.

*iii. Issues Associated Measuring the Investment (The Rate Base)*

The selection of a rate base raises another set of issues. Large variations in the outcome of a fair return calculation result from alternate choices in regard to the measure of the investment (rate base). Whether the original investment should be used as a rate base or whether that investment costs should be adjusted for inflation has been debated. Typically, long-term owners have investments that are low by current standards, while recent purchase prices have low rates of return relative to their investment. In periods of inflation in the prices of real property, the fair return becomes a function of the length of ownership. As a result, the rate of return on investments in apartment buildings with comparable rents and operating costs will vary substantially based on the purchase date of the building.

Some courts have held the investment should be inflation adjusted to reflect the real amount of the investment in current dollars. In *Cotati Alliance for Better Housing v. City of Cotati*, the court concluded that Cotati's return on investment standard was not confiscatory because "[t]he landlord who purchased property years ago with pre-inflation dollars is not limited to a return on the actual dollars invested; the Board may equate the original investment with current dollar values and assure a fair return accordingly."<sup>30</sup> Commonly, if not usually, when rate of return on investment standards are used, the rent setting body has adjusted the original investment by inflation.

However, in other instances California courts have upheld the use of a standard under which investment was calculated in a manner virtually opposite to adjusting the original investment by inflation. Instead they have upheld "...taking the price paid for the property and deducting accumulated depreciation to arrive at a net historic value" See e.g. *Palomar Mobilehome Park Assn. v. Mobile Home Rent Review Com.* (1993), 16 Cal.App.4th 481, 487, the Court reasoned:

[The park owner] argues that "historic cost" approach effectively transfers to tenants the use of \$11 million in assets (the difference between the historic cost of the property and its current value) free of charge. It is true that in calculating a "fair" return, the City's proffered formula does not give park owners credit for any appreciation in the value of their property. Yet this is true any time a "fair return on investment" approach is used in lieu of a "fair return on value" formula. As we have explained ... both the United States and California Supreme Courts have approved the "investment" approach as constitutionally permissible. We are in no position to hold to the contrary by accepting Palomar's value-based test as a constitutional minimum. (*Id.* 16 Cal.App. 4<sup>th</sup> at 488)

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<sup>30</sup> 148 Cal.App.3d. 280, 289 (1983)

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**iv. Outcomes under Alternate Variations of the Rate of Return on Investment Standards**

The table on the following page illustrates how the wide range of possible rate bases and fair rates can lead to vastly diverging results under a rate of return on investment formula.

(Table 5)

**Alternate Outcomes under Rate of Return on Investment Standard  
(Investment x Fair Rate = Fair Net Operating Income)**

<b>Investment (Rate Base)</b>	<b>Fair Rate</b>	<b>Fair Net Operating Income* (fair rate x investment)</b>
<b>\$2,000,000</b> original investment (e.g. 40 apartments x \$50,000 / apartment unit)	5% capitalization rate (prevailing noi/purchase price ratio purchases in 2016)	<b>\$100,000</b>
	7%	<b>\$140,000</b>
	9%	<b>\$180,000</b>
<b>\$1,200,000</b> original investment minus depreciation of improvements	5%	<b>\$60,000</b>
	7%	<b>\$84,000</b>
	9%	<b>\$108,000</b>
<b>\$4,000,000</b> original investment adjusted by CPI	5%	<b>\$200,000</b>
	7%	<b>\$280,000</b>
	9%	<b>\$360,000</b>

\* Allowable rent = fair net operating income + operating expenses

Even if the original investment is inflation adjusted (adjusted by the percentage increase in the CPI since the purchase date), the outcome under a rate of return on investment standard depends heavily on whether an apartment owner purchased during an upward or downward cycle in real estate values. An owner who paid the same price for a property in 2010 (at the end of a flat cycle in apartment values) as an owner paid in 2000 (at the end of a surge in values) is permitted a much lower rent under standard, because the period of inflation used to adjust the purchase price is much shorter.

**v. An MNOI Standard Provides a Fair Return on Investment by Providing the Net Operating income that the Property Yielded in the Base Year**

The use of an MNOI fair return standard in the implementation of ordinances which contain the term “fair return on investment” has been standard.

While an MNOI standard does not incorporate the amount of an owner’s investment into a fair return calculation, it can be viewed as providing a fair return in the sense that it provides the return (net operating income) that the property yielded prior to rent regulation. As noted a California Court of Appeal held that the MNOI standard provides a fair return on investment.

**E. A Standard Providing for Rent Adjustments Based on Increases in Operating Expenses over the Prior Year**

A third methodology for setting allowable rents pursuant to individual rent adjustments provides for rent increases to cover operating cost increases since the prior year, which are not covered by the allowable annual rent increase. This type of standard is in effect under San Francisco and Oakland rent regulations. San Jose used this type of standard until it was replaced by an MNOI standard in 2017.

Under San Francisco’s standard, rent increases above the amount authorized by the annual increase, which are based on operating cost increases, are limited to seven percent.<sup>31</sup> In the past four years, the number of petitions pursuant to this standard has ranged from 43 to 70.<sup>32</sup>

A concern about this type of standard is that substantial variations in annual maintenance expenses can be typical. This type of standard enables apartment owners to obtain increases due to unusually high operating expenses in a particular year or may reward intentional bunching of maintenance expenses which do not recur annually into a particular year. In any case, as a result, this standard can provide for rent increases which cover a surge in operating expenses and allow for increases that are more than adequate in the following years when the operating expenses return to normal levels.

In contrast under the MNOI standard if claimed expenses for a particular year are unusually high, typically they will be adjusted or particular unusual expenses will be amortized.

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<sup>31</sup> S.F.Residential Rent Stabilization and Arbitration Board Rules and Regulations, Sec. 6.10

<sup>32</sup> See Rent Board, Annual Report 2015-2016, p. 11. San Jose’s experience with this type of standard is not “instructive” because it allowed annual rent increases of 8% from the 1982 through 2015.

**F. The Exclusion of Debt Service Costs in Fair Return Standards**

The Richmond ordinance is silent on whether or not debt service costs should be considered.

Eight of the eleven apartment rent control ordinances in California (Los Angeles, San Jose, Oakland, Berkeley, Santa Monica, West Hollywood, East Palo Alto, and Mountain View) specifically **exclude** consideration of debt service in setting allowable rent levels, (except when the debt service is associated with capital improvements).

(Table 6)  
**Treatment of Purchase Mortgage Interest Expenses  
Under Apartment Rent Stabilization Ordinances**

<i>Jurisdiction</i>	<i>Consideration of Purchase Mortgage Interest Expenses</i>	<i>Limitations on Allowance of Debt Service Expenses</i>
<b>Los Angeles</b>	<b>Excluded</b>	
<b>Oakland</b>		Debt service pass-through repealed on April 1, 2014. Pre-repeal purchasers exempted from repeal.
<b>Berkeley</b>		
<b>Santa Monica</b>		
<b>West Hollywood</b>		
<b>Mountain View</b>		
<b>East Palo Alto</b>		
<b>Beverly Hills</b>		
<b>San Jose</b>		

Most of the MNOI standards in mobilehome park rent stabilization ordinances preclude consideration of debt service. Also, consideration of debt service is usually excluded under rate of return on investment standards- because fair return is measured by the return on the total investment, rather than just the cash portion of the investment. (Consistent with using this measure of return, the rate base for measuring the return is the total investment, and the calculation of the return is based on consideration of the whole return, rather than return net of mortgage interest payments.)

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Under the San Francisco, Los Gatos, and Hayward ordinances, increases in debt service may be passed through. However, under the San Francisco ordinance, increases based on debt service increases are limited to 7% and in buildings with six or more units are allowed only once every five years.

### **Rationale for Exclusion of Consideration of Debt Service**

If debt service is considered, owners who make equal investments in terms of purchase price and have equal operating expenses, may be entitled to differing rents depending on differences in the size of their mortgages and/or the terms of their financing arrangements.

Passing through increases in debt service, apart from other allowable rent increases, sets the allowable rent at a level that both:

- 1) provides for reimbursement for the financed cost of purchasing a building, and
- 2) provides the allowable rent increases that would otherwise provide a fair return by providing for increases in net operating income which can be used to finance increasing debt service.

### **Judicial Precedent Regarding Consideration of Debt Service in Fair Return Cases**

The legal precedent, expands on the rationale for the standard policy of excluding consideration of debt service in calculating fair return.

As indicated, Courts have held there is no rational basis for consideration of debt service in a rent setting process.<sup>33</sup> Once court explained:

“Assume two identical parks both purchased at the same time for \$1 million each. Park A is purchased for cash; Park B is heavily financed. Under Palomar's approach, calculating return based on total historic cost and treating interest payments as typical business expenses would mean that Park A would show a considerably higher operating income than Park B. Assuming a constant rate of return, the owners of Park B would be entitled to charge higher rents than the owners of Park A. We see no reason why this should be the case.”<sup>34</sup>

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<sup>33</sup> *Palomar Mobilehome Park Ass'n v. Mobile Home Rent Review Commission* [of San Marcos], 16 Cal.App. 4th 481, 488 (1993);

<sup>34</sup> *Id.*, at 489.

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The same Court of Appeal reaffirmed its conclusion regarding the treatment of debt service expenses. “We have previously rejected the notion that permissible rental rates based on a fair rate of return can vary depending solely on the fortuity of how the acquisition was financed.”<sup>35</sup> More recently, another Court of Appeal again affirmed the view that tying rents to individual owners’ financing arrangements has no rational basis.

Apart from the inequities that would result from permitting a party who financed its purchase of rent-controlled property to obtain higher rents than a party who paid all cash, there are additional reasons for disregarding debt service. ...debt service arrangements could easily be manipulated for the purpose of obtaining larger rent increases, by applying for an increase based on servicing a high interest loan and then refinancing at a lower interest rate or paying off the loan after the increase was granted. Alternatively, an owner might periodically tap the equity in a valuable piece of rental property, thus increasing the debt load. In any event, we discern no rational basis for tying rents to the vagaries of individual owners' financing arrangements.<sup>36</sup>

However, in an earlier case, one Court of Appeal held that consideration of debt service costs was required when it held that mobilehome park owners have a vested right to have their debt service considered if debt service was specifically allowed as an expense under the fair return standard in effect under an ordinance at the time the property was purchased.<sup>37</sup> In that case, The Court concluded the guidelines in effect when the mobilehome park was purchased created vested rights. In 1991, the same court reaffirmed this conclusion.<sup>38</sup>

### III. RECOMMENDATION

As stated above, it is recommended that the Rent Board regulations that include a specific fair return standard. A fair return standard provides guidance not only to the hearing officer but also to the parties impacted by the Ordinance and provides an objective methodology for consistent decisions.

Furthermore, the adoption of a maintenance of net operating income (MNOI) standard is recommended. The standard guarantees a right to rent increases which cover

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<sup>35</sup> *Westwinds Mobile Home Park v. Mobilehome Park Rental Review Bd.*, 30 Cal.App.4th 84, 94 (1994)

<sup>36</sup> *Colony Cove Properties v. City of Carson*, 220 Cal.App. 840,871 (2013). Courts in other states have reached similar conclusions. In 1978, when considering the constitutionality of an apartment rent control ordinance, the New Jersey Supreme concluded that: “Similarly circumstanced landlords ... must be treated alike. Discrimination based upon the age of mortgages serves no legitimate purpose.” *Helmsley v. Borough of Fort Lee*, 394 A.2d. 65, 80-81 (1978).

<sup>37</sup> *Palacio de Anza v. Palm Springs Rent Review Com.*, 209 Cal.App.3d. 116 (1989)

<sup>38</sup> *El Dorado Palm Springs, Ltd.v. Rent Review Com.*, 230 Cal.App.3d. 335 (1991)

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operating cost increases and provide for growth in net operating income over a base year. The standard has been approved in principle by the courts and in challenges to individual decisions applying the standard, its use has been consistently upheld.

In contrast, a rate of return standard would lead to a situation in which rent regulations could be overridden with investments which are not justified by the current rents. While the courts have not rejected a rate of return on investment standard in principle, courts have repeatedly qualified the scope of its use (e.g. for example, by holding that there is no right to a fair return on excessive investments.) In practice rate of return hearings require the application of a particular rate, when there is no single rate that is fair and the opinions of courts and experts about what rates of fair have widely diverged.

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MEMORANDUM

**TO:** Chair Gray and Members of the Rent Board  
**FROM:** Kenneth Baar, Consultant  
**DATE:** February 21, 2018  
**SUBJECT:** FAIR RETURN REGULATIONS

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**I. Introduction**

A central purpose of allowing individual rent adjustments based on fair return standards is to ensure that landlords can obtain a return that meets **constitutional standards** in the event that the combination of annual general adjustments and allowable vacancy rent increases do not permit a fair return.

This memo contains a discussion of the specifics of a maintenance of net operating income (MNOI) fair return standard and a draft MNOI regulation.

Under Richmond’s Fair Rent, Just Cause for Eviction and Homeowner Protection ordinance owners of regulated rental units have a right to a fair return. on investment.

The Richmond Fair Rent and Homeowner Protection Ordinance states that in reviewing individual fair return petitions the Board or hearing examiner shall consider “the purposes of this chapter and shall specifically consider all relevant factors, including (but not limited to)” the following list of enumerated factors. (Section 11.100.070.(g));:

- (1) Increases or decreases in property taxes;*
- (2) Unavoidable increases or any decreases in maintenance and operating expenses;*
- (3) The cost of planned or completed capital improvements to the rental unit (as distinguished from ordinary repair, replacement and maintenance) where such capital improvements are necessary to bring the property into compliance or maintain compliance with applicable local code requirements affecting health and safety, and where such capital improvement costs are properly amortized over the life of the improvement;*
- (4) Increases or decreases in the number of tenants occupying the rental unit, living space, furniture, furnishings; equipment, or other housing services provided, or occupancy rules;*
- (5) Substantial deterioration of the controlled rental unit other than as a result of normal wear and tear;*
- (6) Failure on the part of the Landlord to provide adequate housing services, or to comply substantially*

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*with applicable state rental housing laws, local housing, health and safety codes, or the rental agreement;*

*(7) The pattern of recent rent increases or decreases;*

While the ordinance lists the foregoing factors to be considered for evaluating petitions for fair return rent adjustments, it does not set forth a specific methodology (formula) for determining what rents will permit a fair return. Consideration of these factors is subject to the qualification that upward adjustments shall be allowed only when necessary to permit a fair return. The ordinance states:

*It is the intent of this chapter that individual upward adjustments in the rent ceilings on units be made only when the Landlord demonstrates that such adjustments are necessary to provide the landlord with a fair return on investment. (Sec. 11.100.070.(g)(8))*

The packet for the Rent Board meeting of December 20, 2017 included a lengthy memo on alternate fair return methodologies by this author, with a recommendation to adopt a Maintenance of Net Operating Income (MNOI) standard.

At that meeting, the Board directed staff to prepare a fair return regulation with an MNOI standard.

### **II. Description of the MNOI Standard**

Under an MNOI standard apartment owners are entitled to increases in rents over the base period rent levels which are adequate to cover increases in operating costs since the base year and provide growth in net operating income over the base year level. Mortgage interest is not considered under an MNOI standard.

The following hypothetical illustrates the operation of the MNOI standard. The Maximum Allowable Rent must be adequate to cover the increases in operating expenses of \$30,000 since the base year and provide for growth in net operating income of \$30,000 based on the increase in the CPI since the base year.

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	CPI	Gross Income	Operating Expenses	Net Operating Income	Fair Return Allowable Rent Increase
Base Year	100	\$100,000	\$40,000	\$60,000	
Current Year	150	\$150,000	\$70,000	\$80,000	
Pct. Increase Base Year to Current Year	50%	50%	75%	33%	5%
Fair NOI (Base Year NOI Adjusted by the 50% (100% of the increase in CPI))				\$90,000	
Allowable Fair Return Rent Adjustment (= Fair NOI - Current NOI) (\$90,000 - \$80,000)					\$10,000

**III. Experience under MNOI Standards**

To place the role of fair return rent adjustments in perspective, it is noted that in cities that have had rent controls in place since California since the early 1980's, very few fair return petitions have been filed under MNOI standards. This outcome is probably due to the fact vacancy increases over an extended period have allowed rent increases and, therefore, increases in net operating income, which have exceeded the rate of increase in the Consumer Price Index (CPI). In the case of newly adopted ordinances with a recent base year, the impact of vacancy increases would be more limited, since the proportion of units that have had vacancies since the base year would be much lower

MNOI standards have been commonly used as a fair return standard under rent controls since the 1980's.

**IV. Proposed MNOI Standard – Description and Discussion of Issues**

The proposed standard is largely modeled on a composite of standards that have been in effect for decades. It includes:

- 1) A definition of fair return – base year net operating income (NOI) adjusted by a CPI factor,
- 2) A methodology for determining rental income,
- 3) A list of allowable and excluded operating expenses for the purposes of calculating net operating income,
- 4) A standard for including capital improvements and other non-recurring costs as amortized operating expenses,
- 5) An interest allowance for the amortized cost of capital improvements and other non-recurring expenses that are amortized.
- 6) Standards for the adjustment of the base year net operating income for the purposes of the MNOI analysis on the basis of exceptional situations. (A principal ground is disproportionately low rents in the base year.)

The ordinance sets forth a base date of July 21, 2015 for setting rents pursuant to the Annual General Adjustment Standard. (Section 11.100.070 (a).

**A. Selection of a Base Year**

Under an MNOI standard it is necessary to establish a base year for the purposes of calculating a base year net operating income. The Rent Board has discretion in setting the base year under the fair return standard.

There are alternate rationales for choosing 2014 or 2015 as a base year. 2014 could be considered as the last full year in which rents were set in the absence of regulation or the pending adoption of regulation. The use of 2015 as the base year would incorporate vacancy increases that were implemented prior to the actual effective date of rent control ordinance. If 2015 is set as the base year, rent levels would reflect the fact that some landlords may have known about an impending new rent control law and taken vacancy rent increases between July 21, 2015 and December 30, 2016.

In February 2015, the City Council directed staff to prepare a draft rent control ordinance. An ordinance was adopted in August 2015; however, the Council repealed the ordinance before it went into effect in response to petition compelling the Council to reconsider the enactment. Subsequently, an initiative measure was placed on the ballot. That measure was adopted in November 2016 and went into effect in December 2016.

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In the case of newly purchased properties, landlords may not have base period income and expense data. However, if new purchasers were able to use a base period that was later than the base period for other landlords because they did not have base year information, they would be able to incorporate vacancy increases into their base rent which occurred subsequent to the base year. In contrast pre-base year purchasers would not be able to incorporate these increases into their base rent.

In the case of properties purchased subsequent to the adoption of an MNOI standard, if the base year is later than the purchase, base year NOI could be inflated by minimizing operating expenses in the base year.

Purchasers subsequent to the adoption of an MNOI standard may be considered to be on notice that base year information would be required in order to make a fair return application.

### **A. Establishing Base Year Operating Expenses in the Absence of Data**

MNOI standards usually provide for a method for projecting base year operating expenses in the event that the landlord does not have base year operating expense information. A reasonable presumption is that operating expenses increased by the percentage increase in the CPI since the base year. The proposed regulation includes this presumption and sets forth the principle that projections about increases for particular expenses may be modified based on evidence (e.g. information about increases in property taxes based on Proposition 13, information about utility costs based on rate trends, and/or changes in the level of services.)

### **B. Inflation Based Adjustment of Base Year Net Operating Income (“Indexing”) in Order to Provide a Fair Return**

Fair return standards provide for varying rates of “indexing” net operating income in order to provide a fair return.

Under the Los Angeles, San Jose, and Oakland standards a fair net operating income is equal to the base year net operating income adjusted by 100% of the percentage increase in the CPI since the base year.<sup>1</sup> Santa Monica fair return regulations provide for indexing by 40% of the percentage increase in the CPI; West Hollywood provides for 60% indexing; and Berkeley provides for 65% indexing.<sup>2</sup>

The courts have held that freezing net operating income is confiscatory, but on three occasions have *specifically rejected* the view that 100% indexing is required and upheld standards which provided for indexing net operating income by 40% or 50% of the percentage increase in the

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<sup>1</sup> Los Angeles Rent Stabilization, Just and Reasonable Guidelines, Sec. 242; Oakland, \_\_\_\_\_, San Jose Muni. Code, Sec. 17.23.810.

<sup>2</sup> Santa Monica Rent Control Board, Regulations; Sec. 4106; Berkeley Rent Stabilization Board Regulations Sec. 1264, West Hollywood Municipal Code Sec. 17.44.030 (h).

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CPI.<sup>3</sup> In 2001, in *Galland v. Clovis*, the State Supreme Court held that the concept of “fair rate of return” is a legal term that refers to a “**constitutional minimum.**”<sup>4</sup>

While a limitation of indexing to less than 100% of the percentage increase in the CPI provides for growth in net operating income at less than the rate of increase in the CPI, under the typical circumstance, of an apartment purchase financed by a mortgage, cash flow will increase at a greater rate than the CPI. On the other hand, 100% indexing will still provide protection against unreasonable rent increases.

In the past three decades the differences between 100% indexing and for example 65% indexing have been in the range of one percent a year or less since the rate of increase in the CPI has usually been 3% or less. Differences in indexing rates have a greater impact over a longer period when the cumulative increases in the CPI between the base year and the current year are more substantial. **MNOI increases based on 100% indexing may be higher over a longer period, but over a longer period fewer landlords may qualify for MNOI increases due to vacancy rent increases.** *The following table demonstrates the differences in potential increases using 100%,75% and 50% indexing of CPI.*

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<sup>3</sup> See *Berger v. City of Escondido*, 127 Cal. App. 4<sup>th</sup> 14-15 (2005); *Stardust v. Ventura*, 147 Cal. App.4<sup>th</sup> 1170, 1181-82 (2007); *Colony Cove Properties v. City of Carson*, 220 Cal. App.4<sup>th</sup> 840, 876-877 (2013). These cases involved mobilehome park space rent regulations. However, the judicial doctrine regarding a constitutional fair return is the same for regulations of apartments and mobilehome park space rents. Typically an appellate court opinion on fair return issues will cite cases involving both types of regulations.

<sup>4</sup> 24 Cal.4th 1004, 1026 (2001)

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**Illustration of MNOI Standard Alternate "Indexing" Ratios**

	CPI	Gross Income	Operating Expenses	Net Operating Income	
<b>Base Year</b>	100	\$100,000	\$40,000	\$60,000	
<b>Current Year</b>	150	\$150,000	\$70,000	\$80,000	
<b>Pct. Increase Base Year to Current Year</b>	50%	50%	75%	33%	
				<b>Fair Net Operating Income</b>	<b>Fair Return Allowable Rent Increase</b>
<b>Base Year NOI Adjusted by 25% (50% of the 50% increase in CPI)</b>				\$75,000	None
<b>(Base Year NOI Adjusted by 37.5% (75% of the 50% increase in CPI)</b>				82,500	\$2,500
<b>(Base Year NOI Adjusted by 50% (100% of the 50% increase in CPI)</b>				\$90,000	\$10,000

**C. Allowance for Amortized Cost of Capital Improvements**

The proposed MNOI standard for Richmond provides for the inclusion of the amortized costs of capital improvements as an operating expense. Rent Boards have usually adopted their own amortization schedules for capital improvements which have a detailed breakdown of types of capital improvements, with amortization periods ranging from 5 to 20 years. These schedules are in contrast to the IRS depreciation schedule which has a few broad categories and provides for a 27.5 year amortization period for structural improvements.

Attachment A of this memo includes the amortization schedule of the Santa Monica Rent Control Board amortization schedule and the IRS depreciation allowance schedule.

**Interest Allowance for Amortized Costs**

The proposed interest allowance for amortized costs is uniform for all fair return increase adjustments rather than being based on the actual financing arrangements of the landlord. The rationale is that the all landlords should be provided with the same size rent increases for the same costs and capital improvements regardless of differences in their financing arrangements and/or whether the landlord used cash rather than financing to cover the costs. In three cases, the Court of Appeal has held that differences in allowable rent increases based on an owner's individual financing arrangements has no rational basis.<sup>5</sup>

The amount of the proposed interest allowance is tied to a prime mortgage rate index plus two points at the time the application is filed. This index is recommended because it is most closely tied to the cost of borrowing capital for real estate investments. More commonly, under fair return regulations the allowable interest rate is tied to the prime interest rate for borrowing.

*On the following page is a hypothetical amortization with varying capital improvement amortization periods and interest rates, with explanations about how these varying amortization periods and interest rates would actually impact monthly rent increases.*

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<sup>5</sup> *Westwinds Mobile Home Park v. Mobilehome Park Rental Review Bd.*, 30 Cal.App.4th 84, 94 (1994); *Westwinds Mobile Home Park v. Mobilehome Park Rental Review Bd.*, 30 Cal.App.4th 84, 94 (1994); *Colony Cove Properties v. City of Carson*, 220 Cal.App. 840,871 (2013)

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## Monthly Amortized Costs

### Hypothetical Showing Impacts of Varying Amortization Periods and Interest Rates

The hypothetical below sets forth the monthly payments under alternate amortization standards with varying amortization periods and interest rates for a capital improvement that costs \$5,000 per unit.

To place the hypothetical in perspective, a few observations are noted:

1. Ten years after a fair return increase is permitted, only a small portion of units would be subject to the decision, and therefore, any rent allowances for capital improvements since they would become subject to vacancy decontrol during this period.
2. Improvements with longer amortization periods are more likely to have higher costs per unit.
3. The difference between the monthly allowances for 20 and 27.5 year amortization periods are not substantial.
4. The differences based on one or two percent differences in interest rates are not substantial.

<b>AMORTIZED COST TABLE</b>								
Units in Bldg	10							
Cost	Annual Interest Rate	Amortization Period Years	Amortization Period Months	Total Principal & Interest Life of Improvement	Total Interest Life of Improvement	Monthly Amortized Cost	Annual Amortized Cost	Monthly Cost Per Unit
<b>Varying Amortization Periods - Same Interest Rate</b>								
\$50,000.00	7.00%	5	60	\$59,403.60	\$9,403.60	\$990.06	11880.72	\$99.01
\$50,000.00	7.00%	7	84	\$63,389.26	\$13,389.26	\$754.63	9055.61	\$75.46
\$50,000.00	7.00%	10	120	\$69,665.09	\$19,665.09	\$580.54	6966.51	\$58.05
\$50,000.00	7.00%	15	180	\$80,894.54	\$30,894.54	\$449.41	5392.97	\$44.94
\$50,000.00	7.00%	20	240	\$93,035.87	\$43,035.87	\$387.65	4651.79	\$38.76
\$50,000.00	7.00%	25	300	\$106,016.88	\$56,016.88	\$353.39	4240.68	\$35.34
\$50,000.00	7.00%	28	330	\$112,796.57	\$62,796.57	\$341.81	4101.69	\$34.18
<b>Same Amortization Period &amp; Varying Interest Rates</b>								
\$50,000.00	5.0%	15	180	\$71,171.43	\$21,171.43	\$395.40	4744.76	\$39.54
\$50,000.00	6.0%	15	180	\$75,947.11	\$25,947.11	\$421.93	5063.14	\$42.19
\$50,000.00	7.0%	15	180	\$80,894.54	\$30,894.54	\$449.41	5392.97	\$44.94
\$50,000.00	8.0%	15	180	\$86,008.69	\$36,008.69	\$477.83	5733.91	\$47.78
\$50,000.00	9.0%	15	180	\$91,283.99	\$41,283.99	\$507.13	6085.60	\$50.71
\$50,000.00	10.0%	15	180	\$96,714.46	\$46,714.46	\$537.30	6447.63	\$53.73

**D. Adjustments of Exceptional Expense Levels**

Commonly fair return petitions include one or more categories of exceptional operating expense levels for the current year.

If exceptional operating expense levels are incorporated into a fair return determination, they justify a rent level that will be higher than the level required to permit a fair return in future years when the level of operating expenses returns to its recurring level.

The proposed regulation authorizes adjustments of exceptional expense levels, based on prior year's expense levels, industry standards, and standards of reasonability.

**E. Projections of Operating Expenses in the Absence of Actual Data**

Under IRS regulations income property owners are required to maintain income and expense records for at least three years after a return is filed.<sup>6</sup> The adoption of an MNOI standard provides notice that base year income and operating expenses data is required in order to submit a fair return petition.

MNOI standards commonly include provisions for making projections of base year operating expenses if an owner does not have records of actual expenses. Typically, they provide for presumptions about the percentage increase in operating expenses between the base year and the current year. The proposed regulation includes such provisions.

**F. Ceilings on Amount of Rent Increases within a Year**

Fair return regulations commonly place a ceiling on the amount of a rent increase that can be imposed in a single year in order to avoid rent shock for tenants. When a landlord is required to phase-in the rent increases required to provide a fair return, the landlord is also entitled to interest on the portion of the fair return increase that is delayed because the increase is phased-in.

Santa Monica places a limit of the greater of 12% or \$50 on the amount of an annual increase for units occupied by low-income tenants.<sup>7</sup> Berkeley places a cap on the allowable increase equal which is adjusted each year by the percentage increase in the CPI. The ceiling on the cap is equal to the greater of \$94.22 or 15% of the rent up to a ceiling of \$141.33.<sup>8</sup> It's ceiling on allowable increases within a single year *only applies to rent increases based on historically low rents.*<sup>9</sup> West Hollywood limits the allowable increase based on fair return to 12% in the first year and 12% in the second year, with an interest allowance of 10% on the deferred

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<sup>6</sup> See IRS Publication 583, "Starting a Business and Keeping Records."

<sup>7</sup> Santa Monica Reg. 4107.

<sup>8</sup> Calculation provided by Berkeley Rent Stabilization Board staff.

<sup>9</sup> Berkeley Regulations Sec. 1274.

portion of the increase.<sup>10</sup>

The proposed regulation is modeled after the West Hollywood regulation, except that it provides for an interest allowance tied to mortgage interest rates plus two percent, rather than a fixed rate of 10%, which is high by current standards.

### **G. Allowances for Legal Expenses and Costs of a Fair Return Petition**

Under the proposed regulation, the reasonable costs of obtaining a fair return rent adjustment are considered as an allowable operating expense if they were necessary in order to obtain a fair return. If no increase is permitted the expense would not be considered and if the expense is not reasonable, only a reasonable portion would be allowed.

State law provides that such expenses are an allowable expense if vacancy decontrol is not in effect.<sup>11</sup> In *Galland v. Clovis*, the California Supreme Court held that “the reasonable expenses of seeking rent increases” must be allowable.<sup>12</sup>

The proposed regulation also provides for the amortization of legal expenses that are not annually recurring. This type of requirement is standard and is provided for in the state law that would be applicable if vacancy decontrol were not in effect. The standard amortization period is five years.

### **Policy Alternatives To Be Addressed in Subsequent Memos**

#### **V. Passthroughs of Amortized Costs of Capital Improvements without Fair Return Calculation**

As indicated, the proposed regulation the amortized costs of capital improvements are included as operating expenses. Such an allowance is required in order to permit a fair return. At the same time, the inclusion of the allowance for capital improvement expenses under an MNOI standard does not exclude the adoption of regulations that permit rent adjustments for capital improvements without any consideration of overall income, operating expenses, and net operating income. The issues associated with a separate allowance for capital improvements and possible incentives for particular types of capital improvements will be discussed in a separate memo.

#### **VI. Adjustments of Historically Low Rents**

Some jurisdictions have authorized rent adjustments based on historically low rents without consideration of income, operating expenses, and net operating income. The issues associated with such an allowance will be discussed in a separate memo

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<sup>10</sup> West Hollywood Municipal Code Sec. 17.44.030 (h).

<sup>11</sup> Cal. Civil Code 1947.15

<sup>12</sup> 24 Cal.4th 1003, 1027-28 (2001)

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City of Richmond Rent Program

DRAFT Rent Adjustment Regulations: *Chapter 9 (Standards for Individual Maximum Allowable Rent Adjustments) Regulation 905 (Maintenance of Net Operating Income (MNOI) Fair Return Standard*

## 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>.*

### 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 that the net operating income received by the Landlord in the base year provided a Fair Return.

**2. Fair Return.** A Landlord has the right to obtain a net operating income equal to the 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.

#### 3. Base Year.

a. For the purposes of making Fair Return determinations pursuant to this section, the calendar year \_\_\_\_\_ is the base year. The base year CPI shall be \_\_\_\_\_, unless subsection (b) is applicable.

b. In the event that 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.

#### 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 Expenses in the Base Year.** The Landlord's operating

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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 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 Circumstances in the Base Year.** The gross income during the base year was disproportionately low due to exceptional circumstances. In such instances, adjustments may be 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.
- v. Other exceptional circumstances.

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

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City of Richmond Rent Program

DRAFT Rent Adjustment Regulations: *Chapter 9 (Standards for Individual Maximum Allowable Rent Adjustments) Regulation 905 (Maintenance of Net Operating Income (MNOI) Fair Return Standard*

a. **Gross Rental Income.**

i. Gross rental income shall include:

Gross rents calculated as gross scheduled rental income at one hundred percent occupancy 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 (including property insurance).**

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

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### City of Richmond Rent Program

#### DRAFT Rent Adjustment Regulations: *Chapter 9 (Standards for Individual Maximum Allowable Rent Adjustments) Regulation 905 (Maintenance of Net Operating Income (MNOI) Fair Return Standard*

- 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 be 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 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 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.

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- viii. **The Amortized Costs of Capital Replacements.** 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:

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.

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.

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.

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)*

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## AMORTIZED COST TABLE (EXAMPLE)

Units  
in Bldg      10

Cost	Annual Interest Rate	Amortization Period Years	Amortization on Period Months	Total Principal & Interest Life of Improvement	Total Interest Life of Improvement	Monthly Amortized Cost	Annual Amortized Cost	Monthly Cost Per Unit
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### Varying Amortization Periods - Same Interest Rate

\$50,000.00	7.00%	5	60	\$59,403.60	\$9,403.60	\$990.06	11880.72	\$99.01
\$50,000.00	7.00%	7	84	\$63,389.26	\$13,389.26	\$754.63	9055.61	\$75.46
\$50,000.00	7.00%	10	120	\$69,665.09	\$19,665.09	\$580.54	6966.51	\$58.05
\$50,000.00	7.00%	15	180	\$80,894.54	\$30,894.54	\$449.41	5392.97	\$44.94
\$50,000.00	7.00%	20	240	\$93,035.87	\$43,035.87	\$387.65	4651.79	\$38.76
\$50,000.00	7.00%	25	300	\$106,016.88	\$56,016.88	\$353.39	4240.68	\$35.34
\$50,000.00	7.00%	28	330	\$112,796.57	\$62,796.57	\$341.81	4101.69	\$34.18

### Same Amortization Period & Varying Interest Rates

\$50,000.00	5.0%	15	180	\$71,171.43	\$21,171.43	\$395.40	4744.76	\$39.54
\$50,000.00	6.0%	15	180	\$75,947.11	\$25,947.11	\$421.93	5063.14	\$42.19
\$50,000.00	7.0%	15	180	\$80,894.54	\$30,894.54	\$449.41	5392.97	\$44.94
\$50,000.00	8.0%	15	180	\$86,008.69	\$36,008.69	\$477.83	5733.91	\$47.78
\$50,000.00	9.0%	15	180	\$91,283.99	\$41,283.99	\$507.13	6085.60	\$50.71
\$50,000.00	10.0%	15	180	\$96,714.46	\$46,714.46	\$537.30	6447.63	\$53.73

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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) 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.

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

- i. Mortgage principal or interest payments or other debt service costs and costs of obtaining financing.
- 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.

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- viii. Expenses associated with the provision of master-metered gas and electricity services.
  - 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.
- 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;

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- c. Rent increases resulting from the Net Operating Income analysis shall be allocated equally among all units;
  - 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.
- 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.
  - c. No addendum shall be issued for such proposed capital improvements unless they are completed within 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. If supported by just cause such extensions shall be granted.
- 9.** Any unit which received a vacancy rent increase pursuant to Civil Code section 1954.53 within the 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.

### **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 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

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sought regarding the petitioning year, and the Individual Adjustment may be limited or conditioned accordingly.

If it is determined that the Landlord is not entitled to an Individual Adjustment, the Landlord may implement the full upcoming General 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, and advance the housing policies of the City with regard to low and fixed income persons, minorities, students, handicapped and the aged.

### **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.

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.

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

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twelfth of the interest allowance shall be added on to full monthly increase authorized under the MNOI standard.

**12. Constitutional Right to a Fair Return.**

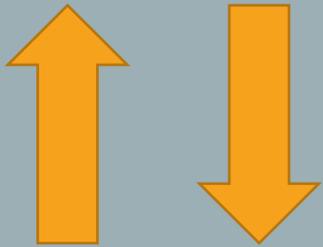
No provision of this regulation shall be applied so as to prohibit the Board from granting an individual rent adjustment that is demonstrated by the Landlord to be necessary to meet the requirements of this ordinance and/or constitutional Fair Return requirements.

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# City of Richmond Rent Program

## SETTING STANDARDS FOR CHANGES IN THE MAXIMUM RENT



Community Workshops | December 2017



# PURPOSE AND BACKGROUND



## PURPOSE OF THIS WORKSHOP

- 1. Provide an overview of the reasons for filing petitions for an individual increase or decrease in the maximum rent**
- 2. Gather community feedback on specific policy options**
  - All comments and notes will be shared with subject matter experts drafting regulations**
  - The Rent Board will consider regulations governing the petition process in December 2017 and January and February 2018**

# RENT REGULATION BASICS

- **The Richmond Rent Ordinance regulates the amount of rent that may be charged for a rental unit in two key ways:**
  1. **The Annual General Adjustment (Inflation, or Cost-of-Living Increase)**
    - **Equal to 100% of the change in the Consumer Price Index**
    - **2016: 3.0%**
    - **2017: 3.4%**
  2. **Individual increases or decreases in the maximum rent granted by the Rent Board Hearing Examiner during the petition process**

## NOT ALL RENTAL UNITS ARE REGULATED

- The following types of properties are exempt from limits on the amount of rent that may be charged (RMC 11.100.070):
  - Single family homes (one dwelling unit on one parcel)
  - Condominiums
  - New construction (unit built after 2/1/1995)
  - Units regulated by another governmental agency (e.g. Section 8, Tax Credit units)
  - Permitted small second dwelling units
  - Tenancies where the Landlord lives and shares a kitchen or bathroom with the Tenant(s)

# STANDARDS FOR MAXIMUM RENT INCREASES

## INCREASE IN EXPENSES: “FAIR RETURN” BASICS

- **Owners covered by rent regulations have a constitutional right to a fair rate of return on their rental property investment.**
- **The Courts are the ultimate arbitrators of what constitutes a fair rate of return.**
- **The Courts have not required the adoption of a particular standard for determining whether or not a fair return is achieved.**
- **Since a fair return standard is not specified in the Ordinance, determining what a fair return means in the City of Richmond must be done legislatively, through regulations adopted by the Rent Board.**



# INCREASE IN EXPENSES: “FAIR RETURN” BASICS ACCORDING TO THE COURTS

- In determining if a fair return has been achieved, Rent Boards must allow for growth in the Net Operating Income (NOI)

**Net Operating Income = All Revenue – All Expenses (excluding debt service)**

- The courts have determined that consideration of debt service has no rational basis. An owner’s individual financing scheme may not merit differences in the maximum rent that may be charged.

**Philosophical question: Should a Landlord who obtained less optimal financing terms (e.g. a higher interest rate) be able to charge higher rents?**

# INCREASE IN EXPENSES: POSSIBLE “FAIR RETURN” STANDARDS

Fair Return Standard	Calculation	Example Cities
<b>Maintenance of Net Operating Income (MNOI)</b>	Fair Rent = Base Year NOI adjusted by CPI increase since base year + operating expenses	Berkeley, East Palo Alto, Santa Monica, Los Angeles, West Hollywood, Oakland*, San Jose, Beverly Hills, Mountain View
<b>Return on Investment (ROI)</b>	Fair Rent = Operating expenses + X% of investment	None - Board would need to determine reasonable rate of return on investment
<b>Return on Value (ROV)</b>	Fair Rent = Operating expenses + X% of value	Not used – Courts determined this is circular
<b>Cost Pass-Through</b>	Fair Rent = Prior year rent + increase in operating costs over prior year	Oakland, San Francisco



# INCREASE IN EXPENSES: MNOI FAIR RETURN STANDARD

Definition of Maintenance of Net Operating Income (MNOI): The net operating income of the current year is compared to a base year, allowing for growth based on CPI and increases in operating expenses.

## Example Calculation:

- A Landlord owns a four-plex. In 2015, the rent was \$1,200 in each unit.

**Monthly revenue = \$1,200 x 4 units = \$4,800**

**Monthly expenses (30% of revenue) = \$1,440**

**Base Year (2015) monthly NOI = \$4,800 - \$1,440 = \$3,360**



## INCREASE IN EXPENSES: MNOI FAIR RETURN STANDARD (EXAMPLE CONTINUED)

- It is now the year 2020, and the Landlord's expenses have increased. The Landlord files a petition on the grounds that they are no longer able to receive a fair return since expenses have increased more than the rent pursuant to the Annual General Adjustment (*let's assume the combined AGA rent increases were 15% between 2015 and 2020.*)

**New monthly revenue = \$1,380 x 4 units = \$5,520**

**Monthly expenses (40% of revenue) = \$2,208**

**Year 2020 monthly NOI = \$5,520 - \$2,208 = \$3,312**

- The Hearing Examiner applies the change in the Consumer Price Index between 2015 and 2020 to the Net Operating Income and rents (*let's assume the combined change in the CPI was 15% between 2015 and 2020.*)

**Permitted 2020 Net Operating Income based on 15% change in CPI = \$3,864**

- The Hearing Examiner determines the rent in each unit may be increased to \$1,518, which allows the Landlord to maintain the same Net Operating Income as the Base Year, including the change in the Consumer Price Index.
- Examples: Berkeley, East Palo Alto, Santa Monica, Los Angeles, West Hollywood, San Jose, Beverly Hills, Mountain View



## INCREASES IN EXPENSES: ALTERNATIVE FAIR RETURN STANDARDS USED IN RENT CONTROL CITIES

**Modified MNOI:** The MNOI standard is modified slightly, to allow for pass-through of cost increases over the prior year without consideration of a base year NOI

- **Examples: Oakland, San Francisco**

**Some Rent Boards have not adopted one standard. Instead, they have a list of factors the Hearing Examiner can consider in making their determination.**

- **Examples: Alameda, Los Gatos, Hayward**



Summary of Community Feedback from Community Workshops  
12/4/2017 and 12/9/2017

Increases in Operating Expenses, Fair Return Standards

**What do you think are the most important factors to consider in setting a fair return standard?**

- One factor includes the high costs that Landlords must pay to improve their rental units and keep them up to code. [*Comment from one property owner: If landlords are not afforded a fair rate of return on their rental properties, in comparison to other investment areas, then inevitably Richmond will end up with more and more run-down housing stock. When the rent for an apartment is locked-in at a price much lower than the going market rent, landlords will have very little incentive to invest money in maintaining and improving their property. This causes landlords to do the bare-minimum in upkeep and spending money, which is a rational response to not receiving a fair return on investment. I would ask that you please take to heart this upspoken downside to rent control that often gets ignored.*]
- Units damaged by previous tenants are another financial burden a landlord has to face.
- Insurance costs to landlords are increasing due to the ability to not add addendum to the current lease (Tenant insurance).
- Considering mortgage payments is an important factor.
- Due to some of their rental units having large families, many Landlords have seen an increase in their utility bills.
- Property taxes have also seen a hike for many Landlords in the previous years.
- Consider the fees that Landlords must pay to conduct business in the City of Richmond (Business License, Fire Prevention, Rental Inspection, and Rental Housing fee).
- Depending on the number of units that a building has, there is a scheduled time as to when they must refinance the building.
- Consider the costs for legal services for issues with tenants.
- Landlords feel that the Annual NOI should stay above the AGI.

## **ITEM G-1 ATTACHMENT 4**

### **2. What did you like or dislike about any of the fair return models presented?**

- Landlords disliked that there was no transparent remedial courses of action regarding tenant and Landlord responsibilities for claims and actions.
- A couple of Landlords did not like the ROI model presented.
- Landlords thought the MNOI model was okay but had questions in regards to excluding the debt service and the rent rollback.
- The ROI model was also questioned and some Landlords wanted to know what exactly was the investment and if it included mortgage payments.

### **3. Please share any additional comments or questions in the space below:**

- A question arose that if a Landlord were to create a rule requiring renter's insurance, would that be considered a "rent increase"?
- Many Landlords voiced their disapproval of the fact that tenants were allowed to add more tenants into their unit and the Landlord could not increase the rent automatically.
- The ROV model also had a few questions in regard to some of the wording used such as the meaning of "value."

# AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: February 28, 2018

Final Decision Date Deadline: February 28, 2018

**STATEMENT OF THE ISSUE:** Section 11.100.060(n) of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance requires the Executive Director to submit to the Board the proposed budget for the ensuing fiscal year at least thirty-five (35) days prior to the beginning of the fiscal year (July 1 – June 30). Given the interrelated nature of the Rent Program Budget, Rental Housing Fee, and billing cycle for the Rental Housing Fee, it is prudent to plan accordingly to ensure Rent Program Department operations remain fiscally feasible.

## 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

- Presentation/Proclamation/Commendation (3-Minute Time Limit)
- Public Hearing                       Regulation                       Other:
- Contract/Agreement                       Rent Board As Whole
- Grant Application/Acceptance                       Claims Filed Against City of Richmond
- Resolution                       Video/PowerPoint Presentation (contact KCRT @ 620.6759)

**RECOMMENDED ACTION:** RECEIVE a proposed timeline for (1) adoption of the Fiscal Year 2018-19 Rent Program Budget; (2) recommendation of approval of the FY 2018-19 Rental Housing Fee to the City Council; and (3) billing of the FY 2018-19 Residential Rental Housing Fee. - Rent Program (Nicolas Traylor 620-6564).

AGENDA ITEM NO:

**H-1.**

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# AGENDA REPORT

**DATE:** February 28, 2018

**TO:** Chair Gray and Members of the Rent Board

**FROM:** Nicolas Traylor, Executive Director

**SUBJECT:** PROPOSED FISCAL YEAR 2018-19 BUDGET, FEE ADOPTION, AND BILLING TIMELINE

## **STATEMENT OF THE ISSUE:**

Section 11.100.060(n) of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance requires the Executive Director to submit to the Board the proposed budget for the ensuing fiscal year at least thirty-five (35) days prior to the beginning of the fiscal year (July 1 – June 30). Given the interrelated nature of the Rent Program Budget, Rental Housing Fee, and billing cycle for the Rental Housing Fee, it is prudent to plan accordingly to ensure Rent Program Department operations remain fiscally feasible.

## **RECOMMENDED ACTION:**

RECEIVE a proposed timeline for (1) adoption of the Fiscal Year 2018-19 Rent Program Budget; (2) recommendation of approval of the FY 2018-19 Rental Housing Fee to the City Council; and (3) billing of the FY 2018-19 Residential Rental Housing Fee.

## **FISCAL IMPACT:**

Adoption of a budget and approval of a fee study for the upcoming 2018-19 Fiscal Year is essential to ensure the Rent Program Department is able to continue to provide services to Richmond community members. The proposed timeline will permit Rent Program staff members to mail bills for the FY 2018-19 Rental Housing Fee in August 2018, with payment due in September 2018 (Attachment 1).

## **DISCUSSION:**

### Background

The Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance establishes that the Rent Board is an integral part of the government of the City, but

## ITEM H-1

shall exercise its powers and duties independent from the City Council, City Manager, and City Attorney, except by request of the Board. While the Ordinance provides that the City Council and City Manager shall have no authority to oversee, supervise, or approve the Rent Program budget, the associated Residential Rental Housing Fee, established by an Ordinance of the City Council, must be approved by the City Council (Attachment 2).

Since the Residential Rental Housing Fee is the Rent Program's only source of revenue for the foreseeable future, it is imperative that the Rent Board budget reflects the interests of both the Rent Board and City Council members.

### Proposed Objectives and Possible Impacts

The proposed Fiscal Year 2018-19 budget is anticipated to contain a number of key changes since the Rent Board's adoption of the Fiscal Year 2017-18 budget. The table below contains a summary of each proposed modification and the possible impacts of such changes.

Proposed Objective	Possible Anticipated Impact(s)
1. Increase compliance with the requirements of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance, including payment of the Rental Housing Fee and all adopted Rent Board regulations, through active enforcement and rent registration	1. Additional resources should be allocated towards compliance and rent registration. This would require a reduction in other line items or increase in the Rental Housing Fee.
2. Determine Residential Rental Housing Fee amount(s) for Rental Units partially or fully covered by the Ordinance to ensure the fee recommended by the Rent Board and charged to Landlords is commensurate with the level of services provided by the Rent Program; contemplate a pass-through of the Rental Housing Fee so the cost is shared between Tenants and Landlords	2. Utilize a tiered-fee approach, such that partially covered units pay a lesser fee than fully-covered Controlled Rental Units; possibly permit a pass-through of a portion of the Rental Housing Fee to be shared between Tenants and Landlords
3. Incorporate new information and data gathered through the owner-occupancy and exemption verification project performed by Rent Program staff members in September-November 2017 to inform estimates of the total number of Rental Units in the City of Richmond	3. Since the number of housing units assessed the Rental Housing Fee will likely decrease due to the subtraction of exempt units from the database, the cost of the budget will be allocated among a smaller number of units, resulting in a probable increase in the amount of the Rental Housing Fee for fully covered Controlled Rental Units.
4. Improve the physical utility of the Rent Program office through the addition of permanent signage and reconfiguration of counseling areas.	4. Additional resources should be allocated towards office furniture, signage, and construction of counseling stations. This would require a reduction in other line items or increase in the Rental Housing Fee.

**DOCUMENTS ATTACHED:**

Attachment 1 – Proposed Fiscal Year 2018-19 Budget, Fee Adoption, and Billing Timeline

Attachment 2 – Ordinance No. 16-17 N.S. An Ordinance of the City Council of the City Council of Richmond Creating the Residential Rental Housing Fee in the Master Fee Schedule for Services Rendered by the City of Richmond Rent Program

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**PROPOSED FISCAL YEAR 2018-19 BUDGET, FEE ADOPTION, AND BILLING TIMELINE**

<b>A. BUDGET ADOPTION</b>		
#	EVENT	PROPOSED DATE
1	Executive Director submits proposed FY 18-19 Budget to the Rent Board	March 21, 2018, Regular Meeting
2	<i>(Optional)</i> Rent Board discusses FY 18-19 Budget	Possible Special Meeting in late March/early April 2018
3	Public Hearing Notice is posted in Contra Costa Times (newspaper); proposed budgets are available for inspection at Rent Program office	April 6, 2018
4	Rent Board considers adoption of FY 18-19 Budget (Public Hearing)	April 18, 2018, Regular Meeting

<b>B. FEE ADOPTION</b>		
#	EVENT	PROPOSED DATE
1	Rent Board receives draft FY 18-19 Fee Study	March 21, 2018, Regular Meeting
2	<i>(Optional)</i> Rent Board discusses FY 18-19 Fee Study	Possible Special Meeting in late March/early April 2018
3	Rent Board approves FY 18-19 Fee Study and recommends to the City Council approval of the FY 18-19 Rental Housing Fee	April 18, 2018, Regular Meeting
4	City Council receives FY 18-19 Fee Study (study session)	May 22, 2018
5	City Council adopts FY 18-19 Fee Study	June 19, 2018

<b>C. BILLING TIMELINE</b>		
#	TASK	PROPOSED SCHEDULE
1	Bills are generated	July 2018
2	Bills mailed	August 2018
3	Rental Housing Fee due	September 2018

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**ORDINANCE NO. 16-17 N.S.**

**AN ORDINANCE OF THE CITY COUNCIL OF THE CITY OF RICHMOND  
CREATING THE RESIDENTIAL RENTAL HOUSING FEE IN THE MASTER FEE  
SCHEDULE FOR SERVICES RENDERED BY THE CITY OF RICHMOND RENT  
PROGRAM**

The City Council of the City of Richmond do ordain as follows:

**SECTION 1.** Section 2.34.040 of the City of Richmond Municipal Code is hereby amended to include the following fees within the various categories:

Description	Percentage of Costs to be Recovered	Proposed Fees
RMC 6.38.110 Section 5 allows the City to collect fees solely to defray actual cost. RMC 6.02.180		
<b>RENT PROGRAM RESIDENTIAL RENTAL HOUSING FEE</b>		
Administration of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance (RMC Chapter 11.100)	100%	As determined by City Council resolution and as set forth in the Master Fee Schedule

**SECTION 2.** Pursuant to Section 2.34.040 of the Municipal Code of the City of Richmond which provides for the establishment of a Master Fee Schedule for the fees to be charged by the various City departments for City services, the City Council of the City of Richmond hereby amends the Master Fee Schedule to create the Residential Rental Housing Fee in accordance with Section 11.100.060(l) of the Municipal Code of the City of Richmond.

**SECTION 3.** Delinquency. Any Landlord as defined in Section 11.100.030(f) of the Municipal Code of the City of Richmond who fails to file any required statement and pay the amount of the Residential Rental Housing Fee prescribed by City Council resolution within thirty (30) days after it becomes due shall be deemed delinquent and shall be assessed the following penalty:

- (1) Ten percent of the Residential Rental Housing Fee if the payment is made within one to thirty days after it became delinquent;
- (2) Twenty-five percent of the Residential Rental Housing Fee if the payment is made within thirty-one to sixty days after it became delinquent; and
- (3) Fifty percent of the Residential Rental Housing Fee if the payment is made more than sixty days after it became delinquent.

Such penalty shall become part of the Residential Rental Housing Fee then required to be paid under this Section 2.34.040 and enabling resolution, and if such delinquency continues thereafter, such person shall be subject to all further penal provisions and remedies contained in this chapter.

**SECTION 4.** City entitled to payment.

- (a) The City shall be entitled to payment from any Landlord as defined in Section 11.100.030(f) of the Municipal Code of the City of Richmond for services rendered by the City of Richmond Rent Program.
- (b) If any Landlord fails to pay the Residential Rental Housing Fee, the Director of Finance shall mail the Landlord a final request for payment for the amounts owed, plus penalties, such as those described in Section 3. The final request shall include a warning notice that

if the Residential Rental Housing Fee is not paid within thirty (30) days, they will be placed on the real property tax rolls. The warning notice shall include information concerning the additional administrative charges that will become due if a lien is recorded against the property, and that the City shall assess the property on the property owner's next property tax statement if the Residential Rental Housing Fee plus any applicable penalties charged to each owner according to the most recent property assessment rolls of the County Assessor is unpaid.

- (c) If the payment is not made by the owner within thirty (30) days, the Director of Finance shall send a certified notice which shall contain the name or names of the owner, the address of the property served, the period of the service, and the amounts due plus penalties.
- (d) The notice shall set a time and place for an administrative hearing before the Director of Finance and shall be mailed to each person to whom the described property for which the service is rendered is assessed on the most recent property assessment rolls of the County Assessor. The notice shall be mailed not less than fifteen (15) days prior to the date of the hearing.
- (e) The Director of Finance shall conduct a hearing. The Director of Finance shall determine whether an assessment should be imposed upon the owner's property.
- (f) If the Director of Finance approves the delinquent charges against the owner of the property and the owner fails to pay said charges, an assessment on the real property for which the service was rendered will be recorded with the Recorder of Contra Costa County. The recorded assessment shall carry an additional administrative charge of \$45.00.
- (g) Delinquent charges which remain unpaid by the owner shall constitute a special assessment against the property to which the service was rendered and shall be collected at such time as established by the County Assessor for inclusion in the next property tax assessment.
- (h) The Director of Finance shall turn over to the County Assessor for inclusion in the next property tax assessment the total sum of unpaid delinquent charges plus penalties as described in Section 3 and administrative charges, plus an assessment charge of \$5.00 as a special assessment against the parcel of property situated within the City to which the service was rendered. The assessment shall be collected at the same time and in the same manner as municipal taxes are collected. The assessment shall be subordinate to all existing special assessment previously imposed on the property. It shall have priority over other liens except for those State, County, and municipal taxes with which it shall have parity. The assessment shall continue until the assessment and all interest and charges due and payable thereon are paid. All laws applicable to the levy, collection and enforcement of municipal taxes shall be applicable to the special assessment.

**SECTION 5.** Severability. If any section, subsection, sentence, clause, phrase or portion of this ordinance is for any reason held invalid or unconstitutional by a court of competent jurisdiction, such holding shall not affect the validity of the remaining portions of this ordinance. The City Council hereby declares that it would have passed each and every section, subsection, phrase or clause of this ordinance irrespective of the fact that any one or more sections, subsections, phrases or clauses be declared invalid or unconstitutional, whether on its face or as applied.

**SECTION 6.** This ordinance shall be effective 30 days after passage and adoption.

\*\*\*\*\*

**ITEM H-1  
ATTACHMENT 2**

First read at a regular meeting of the Council of the City of Richmond held July 18, 2017, and finally passed and adopted at a regular meeting thereof held July 25, 2017, by the following vote:

AYES: Councilmembers Choi, Martinez, Myrick, Willis, Vice Mayor Beckles, and Mayor Butt.  
NOES: None.  
ABSTENTIONS: None.  
ABSENT: None.

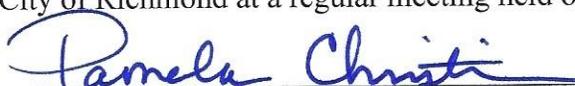
**PAMELA CHRISTIAN**  
CLERK OF THE CITY OF RICHMOND  
(SEAL)

Approved:  
**TOM BUTT**  
Mayor

Approved as to form:  
**BRUCE GOODMILLER**  
City Attorney

State of California                    }  
County of Contra Costa            }       : ss.  
City of Richmond                    }

I certify that the foregoing is a true copy of **Ordinance No. 16-17 N.S.**, passed and adopted by the City Council of the City of Richmond at a regular meeting held on July 25, 2017.

  
\_\_\_\_\_  
Pamela Christian, City Clerk of the City of Richmond

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