# Regular Meeting of the Richmond Rent Board

February 21, 2018 | City Council Chambers

# Item G-1: Adoption of Purpose, Rent Registration, Vacancy Rent Increase, and Rent Adjustment Regulations

Regular Meeting of the Richmond Rent Board | February 21, 2018

# Background

- For most multifamily rental properties (including duplexes) in the City of Richmond, rent increases are limited to the annual change in the Consumer Price Index (a measure of inflation.)
- The Rent Board must adopt regulations establishing standards for allowing individual increases or decreases in the Maximum Allowable Rent for a variety of reasons, such as:
  - Changes in space or services
  - Changes in operating expenses (fair return)*
  - Capital improvements*
  - Historically low rents*

**These rent adjustment standards will be addressed in subsequent Rent Board agenda items.*

# Background (con't)

- At the January 24, 2018, Special Meeting, the Board adopted regulations to inform the procedures where Tenants and Landlords can request adjustments in the Maximum Allowable Rent.
- Additionally, at the January 24, 2018, Special Meeting, the Rent Board received draft Rent Registration, Vacancy Rent Increase, and Rent Adjustment regulations.
- Upon incorporating feedback from community groups and members of the Rent Board, staff members have prepared modified proposed regulations for the Board's consideration and potential adoption.

# Scope of Proposed Rent Adjustment Regulations

- Purpose and Definitions (Chapter 1)
- Rent Registration (Chapter 4)
- Vacancy Rent Increases (Chapter 7)
- Standards for Individual Rent Ceiling Adjustments due to Changes in Space or Services (Formerly Chapter 8, Subchapter C; now Chapter 9)

# Community Engagement Process

## COMMUNITY WORKSHOPS

**December 4, and December 9, 2017:**

- Staff members hosted Community Workshops regarding changes in the Maximum Allowable Rent *(summary of feedback is provided in Attachment 3)*

## PUBLIC REVIEW PERIOD

**January 22, 2018 – February 20, 2018:**

- Draft Rent Registration, Vacancy Rent Increase, and Rent Adjustment Regulations posted on the website (http://www.ci.richmond.ca.us/3521/Rent-Adjustment-Regulations) and sent out over the Rent Program Listserv (1,500+ subscribers)
- Staff members met with representatives of the Fair and Affordable Richmond Coalition and Association of United Richmond Housing Providers to discuss their comments

## RENT BOARD MEETINGS

**January 24, and February 21, 2018 :**

- Rent Board receives and considers draft Rent Registration, Vacancy Rent Increase, and Rent Adjustment Regulations for possible adoption

# Chapter 4: Rent Registration Requirements

Recommended Modifications to Proposed Regulations: **Chapter 4: Rent Registration**

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 402 (Actions and info required to be properly registered) | As written, Landlords are required to provide documentation for Tenancies beginning after July 21, 2015. Shouldn't this be the effective date of the Ordinance instead? | Replace July 21, 2015, with **December 30, 2016**. |
| 402 (Actions and info required to be properly registered) | The requirement to file all "Changes in Terms of Tenancy" in order to be properly registered seems unreasonable. This term is vague. | Replace "Changes in the terms of the tenancy" with **"changes in the provision of Housing Services"** |

## Chapter 7: Vacancy Rent Increases

Recommended Modifications to Proposed Regulations: **Chapter 7: Vacancy Rent Increases**

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 702 (Describes the limited circumstances under which the Maximum Allowable Rent is "frozen") | This regulation restricts a Landlord from obtaining a vacancy rent increase when a Rental Unit has been "red-tagged." But what if the Tenant caused the damage? | Exclude damages incurred by the Tenant or associated occupants, guests, or pets, from those that would restrict a Landlord from establishing a new Base Rent |

Recommended Modifications to Proposed Regulations: **Chapter 7: Vacancy Rent Increases**

## Chapter 7: Vacancy Rent Increases

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 704 (Defines an "original occupant" who may not be given a vacancy rent increase) | Part B states "No existing Tenant shall be required to vacate a Controlled Rental Unit as a result of a covenant or condition in a rental agreement requiring the Tenant to surrender possession." But what about Temporary Tenancy agreements? | Rephrase this provision to state, "No existing Tenant shall be required to a vacate a **Rental Unit** as a result of a covenant or condition in a rental agreement requiring the Tenant to surrender possession **except as permitted under Section 11.100.040(a)(1) of the Ordinance."** |

Recommended Modifications to Proposed Regulations: **Chapter 7: Vacancy Rent Increases**

**Chapter 7: Vacancy Rent Increases**

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 707 (Defines "original occupant" and protects the Landlord's right to a vacancy rent increase when the original occupants no longer reside in the unit) | Part C is unclear as written. | This part has been rephrased to more clearly articulate the intent – that is, to allow a Landlord to establish up to a 6-month buffer period after all original occupants vacate before setting a new Base Rent. The mere acceptance of rent after all original occupants have vacated should not be a waiver of the Landlord's right to establish a new Base Rent. |

Recommended Modifications to Proposed Regulations: **Chapter 9: Standards for Changes in the Maximum Allowable Rent (MAR)**

## Chapter 9: Standards for Individual Rent Ceiling Adjustments (formerly Chapter 8C)

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 903 (Explains when changes in the number of Tenants may result in an increase or decrease in the Maximum Allowable Rent (MAR)) | It is important to address situations where Tenants must take in a brother or sister who is sick or disabled. | Add **caretaker/attendant** to the list of individuals who may be added to the Rental Unit but for which an individual rent adjustment may not be granted and include qualifying language to stipulate that this is true only **as required for a reasonable accommodation for a person with a disability.** |

## Chapter 9: Standards for Individual Rent Ceiling Adjustments (formerly Chapter 8C)

Recommended Modifications to Proposed Regulations: **Chapter 9: Standards for Changes in the Maximum Allowable Rent (MAR)**

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 903 (Explains when changes in the number of Tenants may result in an increase or decrease in the Maximum Allowable Rent (MAR)) | An increase in the MAR of up to 10% for an additional occupant is not enough of an incentive to persuade a Landlord to allow the Tenant to add a friend, partner, boy/girlfriend, etc. | Adopt a policy that would **allow up to a 25% rent increase for the first additional occupant, 12.5% for the second occupant, 6.25% for the third additional occupant,** and so on and so forth (note: this would not apply to the addition of a Tenant's spouse, registered domestic partner, child, grandchild, parent, grandparent, or caretaker/attendant.) |

# Rent Increase Standards for Additional Occupants – Case Study Research

| CITY: | ADOPTED RENT INCREASE STANDARD (IF ANY): |
|---|---|
| **Berkeley** | Up to a 10% rent increase for each additional occupant above the base occupancy level (Regulation 1270) (not applicable to any Tenant who is a spouse, registered domestic partner, child or parent) |
| **East Palo Alto** | None |
| **Los Angeles** | Automatic 10% rent increase for each additional tenant approved by the landlord (Landlord Guide) (not applicable to the first minor dependent child; multiple births (e.g. twins) count as one additional tenant) |
| **Oakland** | None |
| **San Francisco** | No extra rent may be charged solely for an additional occupant to an existing tenancy (Regulation 6.13) |
| **Santa Monica** | None |
| **Richmond (proposed)** | Up to a 25% rent increase for the first additional occupant; 12.5% for second additional occupant; 6.25% for third additional occupant (not applicable to any Tenant who is a spouse, registered domestic partner, child, grandchild, parent, grandparent, legal guardian of a child, parent of any of the Tenants, or caretaker/attendant as required for a reasonable accommodation for a person with a disability.) |

## Chapter 9: Standards for Individual Rent Ceiling Adjustments (formerly Chapter 8C)

# Recommended Modifications to Proposed Regulations: **Chapter 9: Standards for Changes in the Maximum Allowable Rent (MAR)**

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 904 (Explains when changes in space or services may result in an increase or decrease in rent and how decreases are determined) | Regarding increasing the MAR due to the addition of space or services, an increase equal to the "market value" of the space or service is a potentially problematic term given its ambiguity. | Replace "market value" with "**commercially reasonable value**." |

# Chapter 9: Standards for Individual Rent Ceiling Adjustments (formerly Chapter 8C)

Recommended Modifications to Proposed Regulations: **Chapter 9: Standards for Changes in the Maximum Allowable Rent (MAR)**

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 904 (Explains when changes in space or services may result in an increase or decrease in rent and how decreases are determined) | Concerns about the possible misuse in the event a Landlord would like to increase the Rent due to an increase in space or services but some of the Tenants object to the additional service. | Add a provision to the regulation to clarify that increases may be denied if:<br>-The additional space or service does not clearly benefit a majority of the affected Tenants and a Tenant objects<br>-The additional space or service benefits a majority of the affected Tenants but a majority of the affected Tenants object |

# Chapter 9: Standards for Individual Rent Ceiling Adjustments (formerly Chapter 8C)

Recommended Modifications to Proposed Regulations: **Chapter 9: Standards for Changes in the Maximum Allowable Rent (MAR)**

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 904 (Explains when changes in space or services may result in an increase or decrease in rent and how decreases are determined) | What if a decrease in space or services has been caused by the Tenant? It seems unreasonable that a Landlord would suffer a rent decrease due to an event outside of their control. | Modifying the first sentence to read, "The Maximum Allowable Rent shall be adjusted downward **where a Landlord is aware of and causes a Tenant to suffer a decrease in housing services**…" and adding a sentence stating, **"Decreases in the MAR shall not be granted due to a decrease in space or services that is direct result of intentional action on the part of the Tenant to purposefully cause a decrease in space or services."** |

# Chapter 9: Standards for Individual Rent Ceiling Adjustments (formerly Chapter 8C)

Recommended Modifications to Proposed Regulations: **Chapter 9: Standards for Changes in the Maximum Allowable Rent (MAR)**

| Regulation # and Topic | Concern | Recommended Modification (Incorporated) |
|---|---|---|
| 911 (Establishes a process for repayment of rent overcharges) | The fact that a Rental Unit is in violation of the implied warranty of habitability on September 1st of the applicable year should not merit complete loss of that year's AGA. The Tenant should also be responsible for notifying the Landlord of the violation. | Revising the relevant sentence to read, "Where the basis of any overcharge is ineligibility for Annual General Adjustments due to violation of housing codes, the Tenant shall attach documentation indicating that the unit was in violation of the implied warranty of habitability **prior to and as of** September 1st of the applicable year **and that the Landlord was aware of such violation of the implied warranty of habitability.** |

# Additional Suggested Modifications

| Regulation | Recommended Modification |
|---|---|
| Throughout | The first letter of the terms "Tenant," "Landlord," "Controlled Rental Unit," and "Base Rent" shall be capitalized. |
| Throughout | The term "rent ceiling" shall be replaced with "Maximum Allowable Rent" |
| Throughout | Time periods of five (5) days or less will be specified as "business" days. Time periods of greater than five (5) days will be specified as "calendar" days. |
| 903 (Changes in Number of Tenants) | The addition of a fourth provision, where a Tenant may waive their right to a hearing for a rent increase due to an increase in the Base Occupancy Level, in which case a Hearing Examiner may issue an administrative determination for an increase in the Maximum Allowable Rent. |

# Additional Suggested Modifications (continued)

| Regulation | Recommended Modification |
|---|---|
| 903 (Changes in Number of Tenants) | The existing content of Subsection (3) provides if the number of Tenants actually occupying a Rental Unit as a principal residence decreases subsequent to any Maximum Allowable Rent increase for additional Tenants granted pursuant to this subsection, then the Maximum Allowable Rent for that Rental Unit shall automatically decrease by the amount of the rent increase that is no longer justified as a result in the decrease in the number of Tenants). Staff members added a provision to allow for increases in the Maximum Allowable Rent due to an increase in the Base Occupancy Level to remain permanent upon written agreement of the Tenant and Landlord. As such, if the number of tenants actually occupying a rental unit as a principal residence decreases subsequent to any Maximum Allowable Rent increase for additional tenants granted pursuant to subsection (B) (l), then the Tenants may replace the departing Tenant (subject to the Landlord's standard screening methods). |
| 912 (Petition to Obtain Previously Lost Annual General Adjustments (AGAs)) | The addition of a provision that rent increases permitted under this Section shall be applied in a manner consistent with Regulation 17-09 ("Banking" of Annual General Adjustment rent increases.) This would mean than Landlords would not be able to increase the rent more than the current year's Annual General Adjustment plus five percent in any 12-month period. The remaining increases would not be forfeited, but would be banked as to not create instability due to a sudden rent level shock. |

# Proposed Timeline & Next Steps

| Proposed Date | Event |
|---|---|
| February 21, 2018 – Regular Rent Board Meeting | Rent Board considers adoption of Rent Registration, Vacancy Rent Increase, and Rent Adjustment regulations; Rent Board receives Maintenance of Net Operating Income (fair return) regulations |
| February 28, 2018 – Special Rent Board Meeting | Rent Board considers adoption of Maintenance of Net Operating Income (fair return) regulations; Rent Board receives Capital Improvement and Historically Low Rent adjustment regulations |
| Early/Mid-March | Rent Board considers adoption of Capital Improvement and Historically Low Rent adjustment regulations at a possible Special Meeting; Hearing Examiner is onboarded |
| Late March/Early April | First Rent Adjustment Petition hearings are scheduled |

# Recommended Action

- ADOPT Purpose and Definitions Regulations (Chapter 1), Substantive Rent Adjustment Regulations (Chapter 9), Vacancy Rent Increase Regulations (Chapter 7) and Rent Registration Regulations (Chapter 4).

# ITEM H-1: PROPOSED FAIR RETURN STANDARDS

Regular Meeting of the Richmond Rent Board
February 21, 2018
City Council Chambers

# Purpose of Developing a Fair Return Standard

- To provide Richmond rental property owners with a “reasonable (i.e. fair) return”, in cases where Annual General Adjustment increases together with rent increases resulting from new tenancies, do not provide a fair return.

- To adopt Fair Return regulation(s) that meet constitutional standards

# List of Factors Allowed for a Fair Return Rent Increase

| Fair Return Factor | Fair Return Petition/Regulation |
|---|---|
| Increase or decrease in property taxes | **Maintenance of Net Operating Income** |
| Unavoidable increases or any decrease in maintenance and operating expenses | **Maintenance of Net Operating Income** |
| 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 | **Amortized Capital Improvement: cost is included in MNOI**<br><br>Additional Option: **Amortized Capital Improvement** rent increase without MNOI Fair Return petition |
| The pattern of recent rent increases or decreases | **Historically Low Rent Regulation** rent increase that is separate from MNOI analysis |

# General Description of Maintenance of Net Operating (MNOI)Standard

- Owners are entitled to an increase in the Maximum Allowable Rent level to adequately cover increases in operating costs since the base year and obtain net operating income over the base year operating income.

# How MNOI Standards and Resulting Rent Increases Would Work Over Time

- MNOI standards and any rent increases that result are impacted/offset by **vacancy decontrol increases:**
  - Over time Richmond landlords may benefit from mounting vacancy rent increases. This will result in fewer MNOI petitions filed over time. This would be due to the fact that mounting vacancy increases over time may result in rent levels and operating income that have exceeded CPI increases.

# Proposed MNOI Standard

Richmond's MNOI standard is largely modeled on a composite of standards that have been in effect for decades.  The standard includes:

- A definition of Fair Return: Base year net operating income (NOI) adjusted by a CPI factor (e.g. 65% of CPI, 75% of CPI, 100% of CPI).
- A methodology for determining rental income
- A list of allowable and excluded operating expenses
- A standard for including capital improvements and other non-recurring costs as amortized operating expenses
- An interest allowance for the amortized cost of capital improvements and other non-recurring expenses that are amortized
- Standards for the adjustment of the base year net operating income for the purposes of the MNOI analysis on the basis of exceptional situations (such as disproportionally low rents in the base year)

# Selecting a Base Year for MNOI Calculation

The Rent Board has discretion in setting the base year under the Fair Return Standard.

- The two recommended options for a base year are 2014 or 2015.
- Why 2014?
  - 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.
- Why 2015?
  - Using 2015 would incorporate any vacancy rent increases that were implemented prior to the actual effective date of the rent control ordinance.

# What happens when there is no base year operating income data?

- The Fair Return regulation allows for a method to project base year operating expense in the absence of base year data:
  - The base year operating expenses would be projected based on the percentage increase in the CPI since the base year. Without base year data, the base year operating expenses would calculate the CPI in reverse.
  - The proposed regulation also 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).

# Using Inflation to Adjust Base Year Net Operating Income to Provide a Fair Return

- Fair Return standards provide for varying rates of CPI "indexing" of net operating income in order to provide a fair return.
  - Fair net operating income is equal to the base year net operating income adjusted by a percentage of the CPI increase.
  - The courts have rejected the view that 100% indexing is required, meaning that a lesser percentage could be used.
  - The difference between using 100% versus 65% in indexing of net operating income is minimal since the rate of increase in the CPI has been low (e.g. 3% per year) and NOI is about 2/3's of total rental income.
  - Under typical circumstances of an apartment financed with a mortgage, cash flow will increase at a rate greater than 100% of CPI even if NOI increases at less than 100% of CPI. On the other hand, using 100% indexing will still provide protection against unreasonable rent increases.

# Illustration of MNOI Standard Alternative "Indexing" Ratios

| | CPI | Gross Income | Operating Expenses | Net Operating Income |
|---|---|---|---|---|
| | | | | |
| **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% |

| | Fair Net Operating Income | Fair Return Allowable Rent Increase |
|---|---|---|
| **Base Year NOI Adjusted by 25%**<br><br>**(50% of the 50% increase in CPI)** | $75,000 | None |
| **(Base Year NOI Adjusted by 37.5%**<br><br>**(75% of the 50% increase in CPI)** | $82,500 | $2,500 |
| **(Base Year NOI Adjusted by 50%**<br><br>**(100% of the 50% increase in CPI)** | $90,000 | $10,000 |

# 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.

# Important Facts About The 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.

  - 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. Fair return regulations more commonly allowed for an interest rate that is tied to the prime interest rate for borrowing.

# 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 years' expense levels, industry standards, and standards of reasonability.

# 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. 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.

# 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.

# Comparison of Fair Return Rent Increase Limits by City

| Santa Monica | Berkeley | West Hollywood | Richmond (Proposed) |
|---|---|---|---|
| Santa Monica places a limit of the greater of 12% or $50 monthly on the amount of an annual increase for units occupied by low-income tenants. | Berkeley places a cap on the allowable increase equal is adjusted each year by the percentage increase in the CPI. The ceiling on the cap is equal to the greater of $94.22/month or 15% of the rent up to a ceiling of $141.33/month. It's ceiling on allowable increases within a single year *only applies to rent increases based on historically low rents*. | 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 portion of the increase. | The proposed regulation 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. |

# Allowing Landlords to Account for Legal Cost in 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. If the expense is not reasonable, only a reasonable portion would be allowed.
- 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

- The Board has discretion to adopt a regulation that allows for pass-throughs of amortized costs of capital improvements without Fair Return (MNOI) Calculation.

- The Board has discretion to adopt regulation that adjusts rents based on historically low rents without consideration of income, operating expenses, and net operating income.