



MEMORANDUM

Rent Stabilization Program,
Community Development Department

DATE: March 22, 2021

TO: Rental Housing Committee

FROM: Karen M. Tiedemann, Special Counsel
Patricia Black, Analyst II
Anky van Deursen, Rent Stabilization Program Manager

SUBJECT: Draft Regulations Amending Chapter 6: Upward Adjustments

RECOMMENDATION

Review the draft regulations regarding Specified Capital Improvement Petitions and Joint Petition for New and Additional Housing Services and either: (i) provide further direction to staff; or (ii) adopt a resolution approving regulations.

RHC Authority

In November 2016, the voters approved the Community Stabilization and Fair Rent Act (“CSFRA”), which amended the City Charter. The CSFRA regulates the rents of rental properties, with certain exemptions such as single-family homes and duplexes. The CSFRA is a tenant protection law that has three primary goals:

1. Stabilize rents.
2. Provide eviction protections.
3. Ensure a fair and reasonable rate of return on investment.

Section 1700 of the CSFRA stipulates that housing providers are entitled to “a fair and reasonable return on their investment.” The CSFRA provides three methods to ensure a fair return is achieved:

1. General Annual General Adjustment of Rent of 100% CPI-U (Bay Area Region).
2. Vacancy Decontrol.
3. Individual Petitions for Upward Adjustment of Rent (using a Fair Return Standard).

Two of the methods, vacancy decontrol and petitions for upward adjustment of rent, are applicable to capital improvement expenditures.

Sections 1708, 1710, and 1711 of the CSFRA charge the Rental Housing Committee (RHC) with promulgating regulations to implement the petition process and provide landlords with a mechanism for achieving a fair rate of return that addresses individualized circumstances. Section 1708 of the CSFRA empowers the RHC to set rents at fair and equitable levels to achieve the purposes of the CSFRA and establish rules and regulations for the administration and enforcement of the CSFRA. The RHC is empowered to determine how a fair and reasonable rate of return is to be achieved and the CSFRA does not define what is considered a fair and reasonable rate of return.

Section 1710 of the CSFRA provides for petitions for individual rent adjustments, including upward adjustments. Upward adjustments are to be granted only when a landlord demonstrates the adjustments are necessary to maintain a fair rate of return. Sections 1710(a)(2) and (a)(3) set out factors to be included in considering upward adjustment petitions, including the costs of capital improvements that are necessary to bring the property into compliance or maintain compliance with applicable local codes.

Previous Committee Discussion

The RHC in 2017 adopted regulations located in Chapter 6 defining a fair rate of return as the maintenance of the landlord's net operating income for the base year as adjusted by the Consumer Price Index.

The RHC has discussed options for adding an additional standard for upward adjustments to allow landlords to recover the cost of capital improvements in order to incentivize landlords to continue to maintain their properties and to comply with changing codes. The RHC has discussed a capital improvement petition process that would allow landlords to recover costs of certain capital improvements without the necessity of providing detailed property records, thereby allowing for an expedited

hearing process. The RHC deferred further discussion on a capital improvement petition process while Measure D was pending because Measure D would have mandated an expedited capital improvement petition process.

On August 24, 2020, the RHC considered draft regulations for a Specified Capital Improvement Petition Process. As a result of that meeting, the RHC requested the topic be brought back to the Committee at a later meeting date as a Study Session that included input from the community to further inform the discussion. The RHC also requested information for consideration on a draft Joint Petition process between property owner(s) and Tenant(s).

On January 25, 2021, the RHC held a Study Session to provide feedback to staff on potential policy options for two types of petition processes: Specified Capital Improvement Petitions for Temporary Upward Adjustments of Rent and Joint Petition Between Landlord(s) and Tenant(s). The RHC reviewed policy areas for the Capital Improvement Petition Process and gave direction to staff for future regulations. The RHC requested staff provide policy recommendations for the share of costs for capital improvements that included a tier structure that reflects property size, the number of Tenants potentially impacted, and property ownership. Staff was requested to provide a cost-modeling example to further illustrate the proposed structure.

The RHC also reviewed policy areas for a Joint Petition for New and Additional Housing Services Process and requested staff to return with regulations in conjunction with regulations for the Specified Capital Improvement Petition Process.

On February 22, 2021, the RHC held a final Study Session for the Specified Capital Improvement Petition Process. The RHC provided additional policy guidance to staff and requested staff return with draft regulations for final approval.

Staff recommends the RHC consider adopting amendments to Chapter 6 to provide a capital improvement petition process as well as a joint petition process.

ANALYSIS

The Specified Capital Improvement Petition Process and Joint Petition for New and Additional Housing Services Process has been included in Chapter 6 of the regulations, which addresses upward adjustment petitions. The main features of the draft regulations are summarized below.

Specified Capital Improvement Petition Process

A. Summary of Regulations

- (a) Authority for Specified Capital Improvement Petition – CSFRA Section 1710(a) allows landlords to file a petition for an upward adjustment to ensure a fair and reasonable rate of return. The CSFRA does not define what is considered a fair and reasonable rate of return. Section 1708 of the CSFRA empowers the RHC to set rents at fair and equitable levels to achieve the purposes of the CSFRA and establish rules and regulations for the administration and enforcement of the CSFRA. The RHC is empowered to determine how a fair and reasonable rate of return is to be achieved. The amendments to Chapter 6 determine that a fair rate of return can be achieved either by the maintenance of net operating income or by the recovery of costs of certain capital improvements, defined in Chapter 6 as Specified Capital Improvements. Chapter 6 of the Regulations has been renumbered. The Petition process for Specified Capital Improvement Petitions is located in Section F of the renumbered chapter.
- (b) Specified Capital Improvements – The amendments to Chapter 6 would introduce an expedited petition process for certain capital improvements, defined as Specified Capital Improvements (See Subsection C.10 and Appendix B). Specified Capital Improvements are generally major Capital Improvements that significantly extend the useful life of the property. Specified Capital Improvements must also meet the definition of Capital Improvement already part of Chapter 6 (relocated to Subsection C.3). The CSFRA limits the capital improvements that can be considered in upward adjustment petitions to improvements necessary to bring the property into compliance with applicable codes and cannot include costs that could have been avoided by the exercise of reasonable diligence in maintaining the property.
- (c) Petition – Landlords petitioning for a Specified Capital Improvement Temporary Upward Adjustment would be required to complete a petition that includes documentation on the type and cost of Specified Capital Improvement installed. Landlords would also be required to provide limited information regarding the property, primarily the current rent roll, and the date that each Tenant initially occupied the rental unit. This information is required because the CSFRA prohibits the consideration of capital improvements that arose prior to the current tenancy (Section 1710(a)(3)(D)).

- (d) Hearing Process—Once a Specified Capital Improvement Petition is deemed complete and, therefore, accepted by the RHC, affected Tenants will be provided notice and the opportunity to request a hearing on the petition. Tenants requesting consideration of a hardship must do so when requesting a hearing. If no Tenant requests a hearing, a Hearing Officer will decide on the petition without a hearing. If a Tenant requests a hearing, the hearing is to be held within thirty (30) days of the request for a hearing. At the conclusion of the hearing, the Hearing Officer will issue a decision, which is appealable by either the landlord or the Tenant.
- (e) Standards for Specified Capital Improvement Temporary Upward Adjustments.
1. The cost of Specified Capital Improvements, including any interest costs, must be amortized in accordance with the amortization schedule attached as Appendix B.
 2. The total amount of the Specified Capital Improvement Temporary Upward Adjustment is limited to 5% of the rent for any unit subject to the Upward Adjustment, not inclusive of the Annual General Adjustment. If the landlord cannot recover the full cost of the Specified Capital Improvement because of the 5% limitation, the landlord can opt for a longer amortization period.
 3. The total amount of the cost of the Specified Capital Improvement approved shall be shared between Tenants and landlords based on number of units on the rental property as follows:
 - a. For properties with one (1) to five (5) Rental Units, a maximum of ninety percent (90%) of the costs of the Specified Capital Improvements shall be passed on to the Tenants;
 - b. For properties with six (6) to twenty (20) Rental Units, a maximum of seventy-five percent (75%) of the costs of the Specified Capital Improvements shall be passed on to the Tenants;
 - c. For properties with more than twenty (20) Rental Units, a maximum of fifty percent (50%) of the costs of the Specified Capital improvements shall be passed on to the Tenants.

4. Any Specified Capital Improvement Upward Adjustment is temporary and will expire either at the end of the amortization period or when the Tenant vacates the unit. Vacancy decontrol allows property owners to raise rents upon vacancy to recover the cost of any capital improvements.
5. The Specified Capital Improvement Upward Adjustment can only be allocated to units benefitted by the Specified Capital Improvements and will be allocated pro rata to all benefitted units. If not all units benefitted by the improvement are included in the petition, the Hearing Officer will allocate the full cost of the Specified Capital Improvement to all benefitted units and impose the Upward Adjustment only on those units covered by the Petition. In allocating the Upward Adjustment, the Hearing Officer may consider the factors previously approved by the RHC for allocation of upward adjustments such as the relative size of units and Tenant tenure (see Subsection E of Chapter 6).
6. The Specified Capital Improvement Temporary Upward Adjustment is not included when calculating future annual general adjustments.
7. Landlords may petition for approval of Specified Capital Improvements that have not been installed yet, but any Upward Adjustment awarded will not be effective until the Specified Capital Improvements are installed and proof of such installation and final cost is provided to the Hearing Officer.
8. Amendments have also been made to Appendix A, the amortization schedule for capital improvements for MNOI Upward Adjustment Petitions, to further refine the schedule and include additional items.

Joint Petition for New and Additional Housing Services Process

B. Summary of Regulations

- (a) Authority for Joint Petition for New and Additional Housing Services – CSFRA Section 1710(a) allows landlords to file a petition for an upward adjustment to ensure a fair and reasonable rate of return. The CSFRA does not define what is considered a fair and reasonable rate of return. Section 1708 of the CSFRA empowers the RHC to set rents at fair and equitable levels to achieve the purposes of the CSFRA and establish rules and regulations for the administration and enforcement of the CSFRA. The RHC is empowered to determine how a fair and reasonable rate of return is to be achieved. The

- amendments to Chapter 6 determine that a fair rate of return can be achieved either by the maintenance of net operating income or by the recovery of costs of associated with new or additional housing services, including new or additional housing services, additional occupants, new or additional pets, and additional parking and/or storage spaces as defined in Chapter 6.
- (b) New and Additional Housing Services – The amendments to Chapter 6 would introduce an expedited petition process for costs associated with new or additional as outlined below (see Subsection G.1).
1. New or additional housing services that are not included in the written Rental Housing Agreement, including new or additional pets, additional parking, or storage spaces.
 2. Improvements or modifications to the Covered Rental Unit as requested by the Tenant, such as: new flooring, paint, and appliances. The costs of such modifications or improvements shall either be amortized over the useful life of the improvement based on the amortization schedules attached as Appendix A or B, as applicable, or the Tenant and the Landlord may agree to a one-time payment for the Tenant's share of the cost of the improvement or modification. The Tenant's share for the cost of such modifications or improvements cannot exceed the share allocated for Specified Capital Improvements as discussed above.
 3. The addition of an Additional Occupant who is neither an Eligible Family Member (as defined in Section 1705(a)(2)(B) of the CSFRA and in accordance with Chapter 9 of these regulations) nor a roommate who will replace a departing or former roommate in a Covered Rental Unit (as defined under Section E of CSFRA Regulations Chapter 9). Any upward adjustment will terminate in the event the Additional Occupant vacates the Covered Rental Unit.
- (c) Petition – Tenants may file petitions jointly with their Landlord requesting the new or additional Housing Services. Tenants must initiate the Joint Petition for Upward Adjustment. Tenants are responsible for obtaining the Landlord's review and signature on the petition. The completed Joint Petition signed by both the Tenant and the Landlord, along with a copy of the written Rental Housing Agreement for the Covered Rental Unit, must be submitted to the Rental Housing Committee for its review and approval. Additional documentation may be requested as necessary.

- (d) Administrative Review and Decision Process—Upon acceptance of the Joint Petition by the RHC, both parties will be provided notice and a Hearing Officer will be assigned to the petition. The Hearing Officer will review the petition and associated documentation. The Hearing Officer will issue a Decision outlining the allowed increase or one-time payment based solely on the Joint Petition and submitted documentation. The Decision has the same effect as other administrative Decisions of the RHC and will establish the Upward Adjustment in Rent or one-time payment. The Hearing Officer can only deny a Joint Petition for New and Additional Housing Services upon making the finding that the Tenant has not freely consented to the request, e.g., in situations with evidence of duress, misrepresentation, or other acts of misconduct. The decision is not appealable.
- (e) Standards for Joint Petition Upward Adjustments
1. The maximum amount of an Upward Adjustment allowed for a Joint Petition shall be limited to five percent (5%) of the Rent for the Covered Rental Unit and the maximum amount of a one-time payment allowed shall be limited to five percent (5%) of one month's Rent for a Covered Rental Unit.
 2. Any upward adjustment for improvements requested by the Tenant is not be considered part of Rent when determining any Annual General Adjustment authorized pursuant to Section 1707 of the CSFRA.

FISCAL IMPACT

The inclusion of a specified capital improvement petition process and a joint petition process may increase the number of upward adjustment petitions received by the RHC, resulting in increases in the costs associated with hearing process. The RHC budget for Fiscal Year 2020-21 includes \$100,000 for hearing services. Based on the prior volume of petitions, the budget should be adequate to process both types of new petitions. Staff will return to the RHC if incurred expenses exceed budgeted funds for Fiscal Year 2020-21.

PUBLIC NOTICING – Agenda posting.

KT-PB-AvD/JS/8/CDD/HRC
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- Attachments:
1. Draft Amended Chapter 6: Upward Adjustment Regulations (with changes)
 2. Draft Resolution Adopting Amendments to Regulations Chapter 6
 3. Exhibit A – Draft Regulations Chapter 6: Upward Adjustment Regulations