CITY OF MOUNTAIN VIEW

MEMORANDUM

CSFRA, Community Development Department

DATE: October 22, 2018

TO: Rental Housing Committee

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SUBJECT: Study Session Regarding Potential Revisions to Regulations

RECOMMENDATION

To provide direction to staff regarding potential updates of the regulations to allow staff to draft regulation revisions to be reviewed at a future meeting.

BACKGROUND

The Rental Housing Committee ("RHC") has heard two appeals of decisions regarding petitions for upward adjustments of rent and has indicated that it would like to revisit certain regulations. This study session has been scheduled to allow the RHC to discuss two topics: (A) the timeline and schedule to address a fair return petition, and (B) Vega adjustments.

In addition to the two topics noted above, RHC members have identified the following topics, which have been tentatively scheduled for discussion at a study session during the RHC's November meeting: the definition of consumer price index for fair return procedures; the equal allocation presumption for rent increases authorized by a fair return petition; and a tenant hardship process independent of banked increases or fair return petition.

To guide the RHC's October study session, this staff report analyzes specific sections of the regulations that impact the timeline to address fair return petitions and the Vega adjustment, as noted below. The text of select sections of the discussed regulations is provided in full in Appendix 1.

The goal of the study session is for the RHC to consider the regulations and provide direction to staff regarding any modifications. Following any guidance from a majority of the RHC during the study session, staff will prepare revised regulations and/or additional information to be reviewed by the RHC at a future meeting for consideration for adoption.

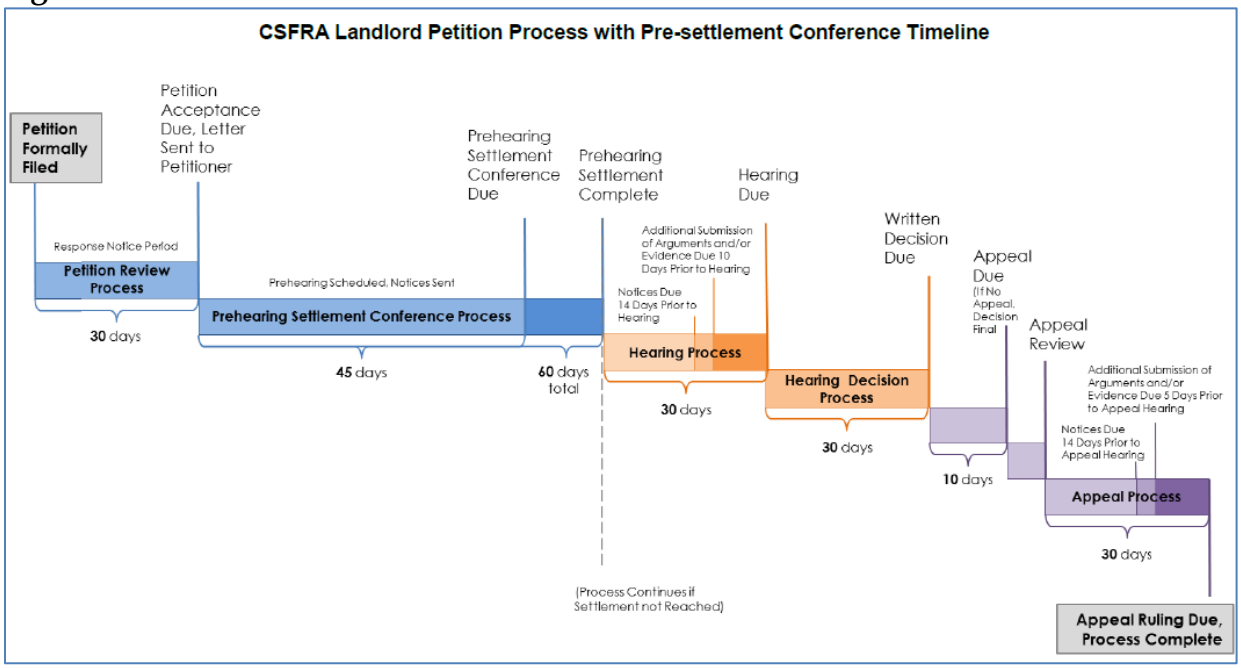
ANALYSIS

The Analysis section of the staff report discusses various aspects of the regulations, with each section concluding with questions and/or potential options to revise the regulations. All questions/options are reviewed in the Summary section, below.

A. Scheduling and Processing Fair Return Petitions

Part A of the analysis section focuses on the scheduling and processing of fair return petitions, identifying specific regulations that may warrant review. Some petitioners and RHC members have stated that the actual timeline to process fair return petitions is too long and/or exceeds the time anticipated in the regulations. Figure 1 visualizes the fair return petition process.

Figure 1 Timeline to Process Fair Return Petitions



As visualized above, the regulations anticipate 150 days from submission of a complete fair return petition by a landlord to the delivery of a written decision of a hearing

officer, which timeline includes an optional prehearing settlement conference. This timeline is extended if the decision is appealed to the RHC. Timelines for three decisions, include two decisions appealed to the RHC, are summarized in the table below.

Table 1 Summary of Case Timelines

Case No.	17180001	17180002	17180006
Initially Submitted	11/6/17	12/22/17	1/16/18
Accepted by RHC	11/19/17	1/4/18	1/24/18
Prehearing Settlement Conference	n/a	2/12/18	n/a
Telephone Conference	n/a	3/7/18	3/3/18
Additional Submission	n/a	4/4/18	3/26/18
In-Person Hearing	1/11/18	5/22/18	6/5/18
Evidentiary Record Closed	1/11/18	6/13/18	6/15/18
Decision Issued	2/12/18	7/16/18	7/27/18
Appeal Heard by RHC	*n/a*	*8/20/18*	*9/24/18*
Submission to Decision (*calendar days*)	99 days	206 days	192 days

As indicated in Table 1, the timeline to process one case was shorter than the regulations anticipate, while processing the two appealed cases took longer than the regulations anticipate. This may indicate that the timeline identified in the regulations accommodates simpler cases, but more complicated petitions will require additional time. As discussed below, the case timelines listed in Table 1 include activities that were not anticipated in the regulations, including a telephone conference and multiple rounds of additional submissions of evidence. Based on these experiences, staff has identified potential issues in the regulations to potentially address the discrepancy between the anticipated and actual schedules to process petitions.

1. Schedule to process petitions (Ch. 4 §O and Ch. 5 §C)

CSFRA section 1706(b) provides that, "[n]o Landlord shall increase Rent for a Covered Rental Unit except as authorized by this Article" and then references annual general adjustments and petitions for upward adjustment of rents. Although aspects of the petition process are described in CSFRA section 1710 (including factors that must be considered in the petition) and section 1711(c) requires adequate notice be provided to the parties, the CSFRA does not define a specific timeline for petitions.

Chapter 4, Section O summarizes the anticipated petition schedule, including a prehearing settlement conference, if requested. Section O states that the prehearing settlement conference should take place within 45 days of submission of a rent decrease petition and within 60 days of submission of a rent increase petition. The prehearing

settlement conference for case number 17180002 was held within this timeframe (52 days).

Chapter 5, Section C provides that hearings shall be scheduled no more than thirty days after the later of when the petition is deemed complete or the prehearing settlement conference is complete. No case identified in Table 1 adhered to this regulation, due in part to the holding of a telephonic conference and additional submission and acceptance of evidence by petitioners and respondents.

Chapter 5, Section D addresses requests to postpone hearings. Anecdotally, staff is aware of numerous requests by various petitioners and respondents for postponements or additional time to submit information. Chapter 5, Section F requires hearing officers to provide a written decision within thirty days of the hearing. No case identified in Table 1 strictly adhered to this regulation. Again, this may be due in part to the submission of evidence by petitioners and respondents to the hearing officer after the in-person hearing date for the two cases that were later subject of appeals to the RHC.

In sum, the timeline in the regulations does not account for observed practices based on two separate but similar issues. First, hearing officers appear to be issuing decisions approximately thirty days after closing the hearing record, but the record is not always closed on the date the in-person hearing is closed. Second and related, petitioners and respondents have submitted numerous rounds of information for petitions, including at the request of hearing officers.

The first issue could be addressed by revising the regulations to acknowledge that decisions will be delivered within thirty days of closing the hearing record, as compared to within thirty days of the in-person hearing. This would allow petitioners and respondents sufficient time to respond to issues that come up at the hearing and still give the hearing officer adequate time to consider the additional information. The second issue is discussed in greater detail with regard to the hearing officer authority (Part A.2 of this memo), and documentary evidence (Part A.3 of this memo).

What modifications, if any, does the RHC wish to make regarding the petition process schedule?

- Modify Chapter 5, Section F to require decision be mailed within 30 days of closing the evidentiary record, notwithstanding the in-person hearing date.
- Other: _____

2. Hearing officer authority to request information (Ch. 5 §§B(4) and C(4))

The CSFRA states that hearing officers shall conduct hearings to act on a petition (section 1711(a)). Section 1711(d) states in part, "Developing the Record. The Hearing

Officer may require either party to a Petition to provide any books, records, and papers deemed pertinent."

Chapter 5, Section B(4) generally describes the authority of hearing officers with respect to petitions and hearings. Section C(4) expressly allows hearings officers to request additional information from any party "prior to or at the hearing."

In practice, hearing officers have requested petitioners and respondents provide additional information and/or respond to concerns raised by the opposing party.

With respect to requests for additional information from petitioners, it appears that hearing officers are indicating that the existing submissions would not carry the petitioner's burden of proof. And so, without additional information from petitioners, the hearing officer would rule against the petition. This iterative process necessarily extends the timeline to decide petitions, but may be more efficient than deciding a petition based on inadequate information, when the petitioner may not have realized the information was available and/or necessary in the eyes of the hearing officer.

One way to address this issue would be to formalize a briefing schedule, including a timeline for the submission of additional information. Another potential means of addressing the issue would be to delete Chapter 5, Section C(4) and prevent hearing officers from requesting information from any party at or after the hearing. Hearing officers ultimately would rely on the record created before and during the hearing, and petitioners would be obliged to provide adequate evidence to carry the burden of proof[1] without the benefit of guidance from hearing officers during the hearing and would not be able to submit evidence to rebut information provided by the other party at the hearing.

What modifications, if any, does the RHC wish to make regarding hearing officer authority to request information?

- Consider formalizing the telephone conference for the hearing officer to manage the petition schedule and to coordinate a briefing schedule and evidentiary submissions.
- Delete Chapter 5, Section C(4) and prevent hearing officers from requesting information from any party at or after the in-person hearing.
- Other: _____

[1] See discussion of the burden of proof in Section C (Documentary evidence required for petitions) of this staff report.

3. Documentary evidence required for petitions (Ch. 4 §H and Ch. 5 §G)

Chapter 4, Section H and Chapter 5, Section G discuss the documentary evidence and burden of proof required for petitions for upward adjustments of rent. The regulations attempt to clarify the burden of proof identified in the CSFRA. Specifically, CSFRA section 1711(h) states in part that "No Petition for Individual Rent Adjustment, whether upward or downward, shall be granted unless supported by the preponderance of the evidence . . ." and CSFRA section 1710(a) states in part that "individual upward adjustments in Rent [can] be granted only when the Landlord demonstrates that such adjustments are necessary . . ."

One aspect of the documentary evidence requirement is discussed above in Part A.2 of this staff report, discussing requests for information/evidence from hearing officers. The RHC has previously discussed whether line items (or sub-items) within a petition for upward adjustment may be standardized or if no evidence is required for line items below a certain threshold such as a percentage of income or a specified dollar amount.

As quoted above, petitioners must carry the burden of proof for a petition to be granted. The burden of proof is the preponderance of the evidence, which the California Civil Jury Instructions describe as follows:

> A party must persuade you, by the evidence presented in court, that what he or she is required to prove is more likely to be true than not true. This is referred to as "the burden of proof."
>
> After weighing all of the evidence, if you cannot decide that something is more likely to be true than not true, you must conclude that the party did not prove it. You should consider all the evidence, no matter which party produced the evidence. (CACI 2017, § 200; *see also* Evid. Code §115)

Identifying thresholds (dollars or percentages) under which certain line items would be presumed proven in the petition context raises at least two issues. First, an appropriate threshold must be identified for specific line items. Second, assuming a threshold is identified, what evidence would be required to rebut the presumption that the line item is applicable to a particular petition?

Currently, the regulations provide one example of this sort of presumption with regards to management expenses.[2] The six percent presumption was based in part on

[2] Regulation Chapter 6, Section E(1)(g) presumes that reasonable management expenses should not exceed six percent of gross income. Petitioners (landlords) may prove that higher management expenses are applicable to a petition by showing that their actual management expenses did not exceed amounts

the practices of other rent stabilized jurisdictions (e.g. Berkeley, Santa Monica, and West Hollywood, *see* Staff Report dated July 10, 2017). Similar support should be identified for any other presumptions adopted by the RHC.

A table summarizing the documentary evidence required in other rent stabilized jurisdictions is included as Attachment 2.

What modifications, if any, does the RHC wish to make regarding documentary evidence requirements in light of the burden of proof required in the CSFRA?

- Identify evidence to support presumptions for specific expenses, such as:
  - _____
  - _____
- Other: _____

B. Vega Adjustments

Part B discusses the Vega adjustment, including: (1) the legal obligation to allow a Vega adjustment, and (2) options to provide certainty and clarity for hearing officers and the RHC to implement Vega adjustments.

1. Required Vega adjustment regulation (Ch. 6 §G(2))

CSFRA section 1711(m) states: "No provision of this Article shall be applied so as to prohibit the Committee from granting an Individual Rent Adjustment that is demonstrated by the Landlord to be necessary to provide the Landlord with a fair rate of return."

In conjunction with the regulations that calculate a fair rate of return based on a maintenance of net operating income (MNOI) methodology, Regulation Chapter 6, Section G(2) provides a safety valve to ensure landlords are not locked into unusually low rents in perpetuity just because rents were low in the base year. Specifically, Section G(2) allows landlords to "demonstrate[e] peculiar circumstances unique to the property that caused either the Gross Income or Operating Expenses during the Base Year to differ significantly from either the Gross Income or Operating Expenses of other properties of similar size, quality, and conditions."

"ordinarily charged by commercial management firms for similar residential rental properties." Likewise, respondents (tenants) may argue that purported management expenses are not reasonable or are unusually high in light of the actual level of management services provided (Chapter 6, Sections (E)(1)(g) and E(3)).

This safety valve is named after a California court case about unusually low base year rents, which was complicated by the interaction of a rent control ordinance in Los Angeles County and a new rent control law in the then-recently incorporated city of West Hollywood.[3] A brief review of the *Vega* case and other court cases on the topic is included as Attachment 3. To summarize, the court required the city to increase the unusually low base year rents for purposes of calculating the landlord's fair return using West Hollywood's MNOI methodology. The case quotes the California Supreme Court, which requires rent control programs to include an adjustment mechanism to provide for "situations in which the base [year] rent cannot reasonably be deemed to reflect general market conditions."[4]

In practice, Section G(2) allows landlords to request a Vega adjustment, as required by California courts. However, Section G(2) provides little guidance on how to implement the Vega adjustment, requiring that a petitioner apply general market conditions to the subject property (e.g. compare gross income and/or operating expenses of other properties of similar size, quality, and conditions). To do so the petitioner would likely need to hire a professional appraiser to adequately document either gross income or operating expenses for properties similar to their own in size, quality, and condition in 2015. In the Vega case, the landlord hired such an expert to demonstrate that the base year rents were too low in the context of general market conditions.

Staff is unaware of any concerns related to Chapter 6, Section G(2).

2. Optional Vega adjustment methodology regulation (Ch. 6 §G(3))

Chapter 6, Section G(3) creates a standard methodology for Vega adjustments. With the standard methodology, landlords do not need to hire an appraiser. However, Section G(3) is an optional method of seeking a Vega adjustment, and a petitioner could still choose to hire an appraiser like the petitioner in the Vega case.

In short, Chapter 6, Section G(3) provides one method to compare base year (2015) income with base year general market conditions. It is a two-step process:

1. Petitioners compare average monthly rents actually earned in 2015 with monthly rents for 2015 in Santa Clara County published by the U.S. Department of Housing and Urban Development (HUD). HUD estimated that the rental amounts would pay for forty percent of available units in the county (e.g. the HUD rents were estimated to be *more* expensive than 40% of the units available in 2015 and cheaper than 60% of units available for rent in

[3] *Vega v. City of West Hollywood* (1990) 223 Cal. App. 3d 1342.
[4] *Id.* at 1349 (quoting *Birkenfeld v. City of Berkeley* (1976) 17 Cal. 3d 129, 169).

2015). If actual rents received in 2015 were less than the HUD rents, the regulation creates a presumption that the 2015 rents were too low.

2. If the petitioner passes step one, then the respondents (tenants) can argue that the general market conditions (e.g. physical conditions like amenities, and the size, quality, and location of individual units or the property overall) justify the low rents received in 2015. In other words, this step places the burden on tenants to show rents received in 2015 were reasonable based on the general market conditions applicable to the property.

Staff is aware of the following concerns regarding the optional Vega adjustment methodology created by Chapter 6, Section G(3). Some argue that the HUD rents are too high; others argue they are too low. Moreover, some have indicated that step two of the Vega adjustment standard is ambiguous or offers too much discretion to hearing officers.

The attached report to the RHC dated August 28, 2017 provided information regarding the HUD rents and other options to identify unusually low base year rents (Attachment 4). To address the latter concern, the RHC could potentially provide greater guidance to hearing officers regarding the valuation of specific property conditions or amenities, such as central air and/or heat, dishwasher, laundry facilities, elevators, etc. The RHC could also repeal Section G(3) and rely solely on Section G(2) to provide for Vega Adjustments.

What modifications, if any, does the RHC wish to make regarding the optional Vega adjustment methodology in Chapter 6, Section G(3)?

- Identify evidence to support presumptive valuations for specific conditions or amenities, such as: central air and/or heat, dishwasher, laundry facilities, elevators, etc.
- Delete Section G(3) and rely on Section G(2) to fulfill state law requirements.
- Other: _____

SUMMARY

A. Processing of fair return petitions

1. *What modifications, if any, does the RHC wish to make regarding the petition process schedule?*
   - Modify Chapter 5, Section F to require decision be mailed within 30 days of closing the evidentiary record, notwithstanding the in-person hearing date.
   - Other: _____

2. *What modifications, if any, does the RHC wish to make regarding hearing officer authority to request information?*
   - Consider formalizing the telephone conference for the hearing officer to manage the petition schedule and to coordinate a briefing schedule and evidentiary submissions.
   - Delete Chapter 5, Section C(4) and prevent hearing officers from requesting information from any party at or after the in-person hearing.
   - Other: _____

3. *What modifications, if any, does the RHC wish to make regarding documentary evidence requirements in light of the burden of proof required in the CSFRA?*
   - Identify evidence to support presumptions for specific expenses, such as:
     - _____
     - _____
   - Other: _____

B. Vega adjustments

What modifications, if any, does the RHC wish to make regarding the optional Vega adjustment methodology in Chapter 6, Section G(3)?
- Identify evidence to support presumptive valuations for specific conditions or amenities, such as: central air and/or heat, dishwasher, laundry facilities, elevators, etc.
- Delete Section G(3) and rely on Section G(2) to fulfill state law requirements.
- Other: _____

FISCAL IMPACT—None.

PUBLIC NOTICING—Agenda posting.

ATTACHMENTS
1. Text of Specified Regulations
2. Summary Table of Documentary Evidence Requirements
3. Review of Vega adjustment case law
4. Staff Report to RHC dated August 28, 2017