



MEMORANDUM

CSFRA, Community Development Department

DATE: November 26, 2018

TO: Rental Housing Committee

FROM: Karen M. Tiedemann, Special Counsel to the Rental Housing Committee
Justin D. Bigelow, Special Counsel to the Rental Housing Committee
Anky van Deursen, Associate Planner

SUBJECT: Study Session Two 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

This second study session has been scheduled to allow the RHC to discuss 3 topics: (A) the definition of consumer price index for fair return procedures; (B) the equal allocation presumption for rent increases authorized by a fair return petition; and (C) allowing tenant hardship petitions for any proposed rent increase, including an annual general adjustment.

To guide the RHC's November study session, this staff report analyzes specific sections of the regulations relating to the definition of consumer price index and the presumptive allocation, as well as a tenant hardship process applicable to all rent increases. Text of select sections of the regulations is provided in Attachment 1.

The goal of the study session is for the RHC to consider the regulations and concepts in order to provide direction to staff regarding any modifications. Following any guidance from 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 and potential 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.

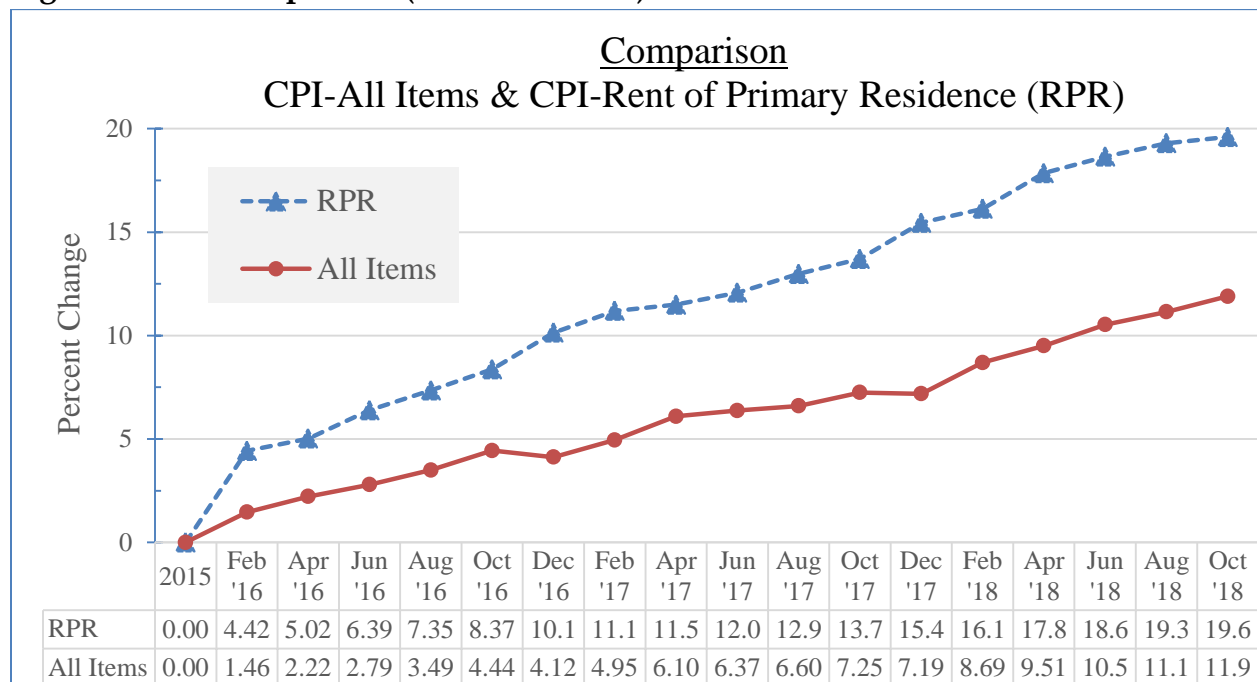
A. Definition of consumer price index for fair return procedures

The consumer price index (CPI) measures the average change over time of prices for a market basket of consumer goods and services. For purposes of the annual general adjustment, CSFRA Section 1707(a)(1) defines the CPI to be "CPI-All Items" for the San Francisco area, which index measures the change in price of the greatest number of consumer goods and services, as compared to other indices.

Chapter 6 Section C(4) defines the CPI used for fair return procedures to equal the "Rent of primary residence," which index measures changes in price of one component of the market basket of consumer goods and services, and is one component of CPI-All Items.

The Rent of primary residence index has increased more than CPI-All Items. In practice, Chapter 6 Section C(4) means that a landlord's net operating income should increase at the same rate of inflation as the Rent of primary residence component instead of increasing at the same rate as CPI-All Items (*see* Figure 1, below).

Figure 1 CPI Comparison (2015 - Oct. 2018)



A. *What modifications, if any, does the RHC wish to make regarding the definition of consumer price index for purposes of fair return petitions?*

1. Modify Chapter 6, Section C(3) to CPI-All Items.
2. Other: _____

B. Allocation of allowed increases based on a petition

The purpose of the CSFRA, as defined in Section 1700, is: "to promote neighborhood and community stability, healthy housing, and affordability for renters in the City of Mountain View by controlling excessive rent increases and arbitrary evictions to the greatest extent allowable under California law, while ensuring Landlords a fair and reasonable return on their investment and guaranteeing fair protections for renters, homeowners, and businesses."

Chapter 6, Section J interprets the mandate of controlling excessive rent increases in the fair return petition context by setting a base rule that rent increases authorized by a petition are distributed equally among all units in a building subject to a petition, unless the hearing officer or RHC determines that a different allocation would be more just, ensure fairness, and further the purposes of the CSFRA.

The concern has been raised that equal allocation among all units would assign increases to units that are: (1) not subject to the petition, and/or (2) at or near market rate rents. Each concern is briefly discussed below.

First, it was not intended that rent increases would be allocated to units not subject to a petition. The fair return standard adopted by the RHC defines a fair return on a per-property basis, not a per-unit basis. (*See* Regulation Chapter 6, Sections B and C(5).) Accordingly, all units in a property subject to a fair return petition should be considered "subject units." Confusion appears to have arisen based in part on Regulation Chapter 4, Section A(2), which allows a petitioner to request an increase applicable to "one or more" units. Regulations could clarify that all units in a property are always subject to a petition to increase rents based on the fair return standard, which would preclude any possibility that an authorized rent increase could not be imposed by a petitioner. The Regulations could further clarify that a petitioner's proposed allocation of rent increase is encouraged, but not necessary.

With respect to the presumption in favor of equal allocation, equally allocating rent increases among all subject units avoids relying solely on the petitioner's proposed allocation of increases. Petitioners' proposed selection of units and allocation of rent increases should be considered by Hearing Officers when allocating rent increases, but petitioners' proposals should also be scrutinized. Solely relying on a petitioner's decision to include or exclude units would be a rejection of the authority, and arguably the mandate, of the CSFRA to control excessive rent increases and arbitrary evictions to the greatest extent allowable under California law while ensuring landlords a fair and

reasonable return. Presumptively allocating rent increases equally among all units offers one counterpoint for Hearing Officers and the RHC to consider when also considering petitioner's allocation requests.

Second, it has been claimed that the presumption for equal allocation would require landlords to raise rents to an amount greater than the market (and tenant households) would accept. This risk may be more theoretical than practical. For instance, at least one recent petitioner requested that a Hearing Officer authorize rent increases that would result in higher rents for smaller units with long term tenants than a larger unit that was more recently rented. This example demonstrates that petitioner's proposed rent increases warrant scrutiny. If the presumption for equal allocation truly conflicts with actual market conditions, the presumption expressly allows for other allocations that are fair and further the purposes of the CSFRA.

In practice, the presumption for equal allocation protects tenants from excessive rent increases and potentially being priced out of their units by providing uniformity for all tenants, instead of requiring a subset of tenants to carry the burden of ensuring a landlord may earn a fair return. Whether characterized as a benefit or flaw, each tenant household would be subject to the same dollar increase, regardless of the duration of their tenancy.

As noted above, the RHC could modify the presumption for equal allocation in one or more of the following ways:

1. Discontinue linking the "subject units" with the landlord's proposed rent increase. For instance, regulations could require that petitions include all units in the property, regardless of the petitioner's proposed allocation of rent increases. Such a rule would alleviate the concern that a landlord could not impose a rent increase because the landlord did not identify one or more units as subject to the petition.
2. Provide guidance to hearing officers when the presumption for equal allocation may not be appropriate. As indicated above, equal allocation may be appropriate when a petitioner proposes that smaller-sized subject units should command greater rents than larger units, depending on unit features and conditions. Similarly, equal allocation may be inappropriate where a new tenancy was created in the last six months and the rent is already at market rate (though that rental amount might be instructive regarding the maximum amount of rent to be charged for a subject unit).
3. Provide alternate potential methodologies for the allocation of rent increases, such as increasing all subject units by a percentage of the existing-rent applicable to each unit, respectively.

B. *What modifications, if any, does the RHC wish to explore regarding the presumptive allocation of rent increases authorized by a petition in Chapter 6, Section J?*

1. Require all units in a building subject to a petition be considered "subject units" so that any increases allocated to those units may be imposed by petitioner.
2. Provide guidance to hearing officers regarding when the equal allocation presumption should and should not be used.
3. Provide one or more new allocation methodologies that further the purposes of the CSFRA and potentially counterbalance concerns with petitioner-proposed allocations.
4. Other: _____

C. Tenant Hardship Process for Any Rent Increase

CSFRA Section 1707(d) expressly authorizes the RHC to create a hardship process to assist tenant households that are subject to a rent increase that would cause an undue hardship based on the use of banked, unimplemented annual general adjustments (AGA). Regulation Chapter 7, Section C implements a hardship petition process for tenants subject to rent increases that include a banked AGA.

CSFRA Section 1710(a)(2) provides a non-exclusive list of factors that must be considered in a fair return petition to increase rents. Regulation Chapter 6, Section K requires that a *bona fide* hardship claim must also be considered in a fair return petition.

Neither regulation requires a specific outcome or method of addressing a *bona fide* hardship, but allows hearing officers to grant relief to tenants experiencing a hardship so long as the relief does not deprive a landlord of the ability to earn a fair return.

CSFRA Section 1707(a) defines AGAs and states that the AGA "is the percentage by which the Rent for existing tenancies in Covered Rental Units may be increased each year, subject to the limitations of [the CSFRA]." The CSFRA does not discuss a hardship procedure applicable to an AGA, unless the AGA is banked. The RHC has previously defined policy where the text of the CSFRA was ambiguous or silent. As noted above, the existing tenant hardship procedure applicable to banked AGAs, does not mandate a specific outcome or form of relief so long as the relief does not deprive a landlord of the ability to earn a fair return.

C. *What direction, if any, does the RHC wish to provide regarding a tenant hardship procedure applicable to annual general adjustments (AGAs)?*

1. Explore modification of Chapter 7 to apply to AGAs.
2. Other: _____

SUMMARY

A. *What modifications, if any, does the RHC wish to make regarding the definition of consumer price index for purposes of fair return petitions?*

1. Modify Chapter 6, Section C(3) to CPI-All Items.
2. Other: _____

B. *What modifications, if any, does the RHC wish to explore regarding the presumptive allocation of rent increases authorized by a petition in Chapter 6, Section J?*

1. Require all units in a building subject to a petition be considered "subject units" so that any increases allocated to those units may be imposed by petitioner.
2. Provide guidance to hearing officers regarding when the equal allocation presumption should and should not be used.
3. Provide one or more new allocation methodologies that further the purposes of the CSFRA and potentially counterbalance concerns with petitioner-proposed allocations.
4. Other: _____

C. *What direction, if any, does the RHC wish to provide regarding a tenant hardship procedure applicable to annual general adjustments (AGAs)?*

1. Explore modification of Chapter 7 to apply to AGAs.
2. Other: _____

FISCAL IMPACT – None.

PUBLIC NOTICING – Agenda posting.

ATTACHMENTS

1. Attachment 1: Text of Specified Regulations