

### Attachment 3

## DRAFT Text Revising Vega Adjustment Regulations

### Chapter 6 § G(3)

#### 3. Optional Vega Adjustment Standard.

- a. Purpose. Subsections (G)(1) and (G)(2) of this Chapter 6, presume that the Net Operating Income produced by a property during the Base Year provided a fair return, and allow a Landlord to demonstrate that the Net Operating Income produced by a property during the Base Year did not provide for a fair return, respectively. This subsection (G)(3) of Chapter 6 creates an optional method through which a Landlord may demonstrate that Base Year Net Operating Income does not provide for a fair return. This subsection (G)(3) identifies a threshold: if average monthly Rent received in the Base Year for a Rent Stabilized Unit is above the threshold, a Landlord retains the burden of proof to demonstrate that Base Year Net Operating Income is unusually low due to peculiar circumstances; if average monthly Rent received in the Base Year for a Rent Stabilized Unit is below the threshold, then it is presumed that the Landlord has met the burden of proof identified in subsection (G)(2) and a responding Tenant shall have the burden of proof to demonstrate that the average monthly Rent earned in the Base Year (and therefore the Net Operating Income) reasonably reflected general market conditions as applied to the Rent Stabilized Unit and property based on its physical location, condition, and amenities relative to similarly situated rental units and/or properties.
- b. Presumptive Threshold Defining Unreasonably Low Base Year Gross Income. The Landlord, in a Petition for Upward Adjustment of Rents, will be presumed to have rebutted the presumption that the Net Operating Income produced by a property during the Base Year provided a fair return on investment for the property if the average monthly Rent received in the Base Year for an individual Rent Stabilized Unit in the property was unusually low as defined in this subsection. For purposes of this subsection (G)(3), unusually low means that the average monthly Rent received for the occupancy and use of the Rent Stabilized Unit was less than the fair market rents published by the U.S. Department of Housing and Urban Development for Fiscal Year 2015 for Santa Clara County as replicated in the table below ("HUD Rents"), for the most similar unit type based on the number of bedrooms.

Efficiency	1-Bedroom	2-Bedroom	3-Bedroom	4-Bedroom
\$1,213	\$1,419	\$1,809	\$2,551	\$2,892

- c. Calculating the Average Monthly Rent Received in the Base Year for an Individual Rent Stabilized Unit. To calculate the average monthly Rent received in the Base Year for purposes of this subsection (G)(3), divide the sum of all Rent received that relates to one Rent Stabilized Unit subject to the petition by the number of months for which Rent was received for that unit, regardless of the number of tenants occupying, or the number of tenancies for, that Rent Stabilized Unit in the Base Year. (See example h.i, below).
- d. Presumptive Recalculation of Base Year Gross Income. If the average monthly Rent received for an individual Rent Stabilized Unit in the property during the Base Year was less than the HUD Rents (noted in subsection (b) of this Section G(3) above) and that Rent Stabilized Unit is subject to a Petition for Upward Adjustment, then the Base Year Gross Income for the property shall presumptively be recalculated for purposes of determining the Base Year Net Operating Income by: (i) subtracting the actual Rent received from such Rent Stabilized Unit(s) for which the average monthly Rent received was unusually low in the Base Year; and (ii) replacing the actual Rent received for such unit(s) with the HUD Rent for the most similar unit type and for the same dates of occupancy in the Base Year. (See example h.ii, below).
- e. Challenging a Presumptive Recalculation of Base Year Gross Income.
- i. Burden on Respondents. One or more Respondents/Tenants may challenge, contest, or dispute any presumptive recalculation of the Base Year Gross Income for purposes of determining the Base Year Net Operating Income applicable to a Landlord's Petition for Upward Adjustment of Rent. A Respondent/Tenant must demonstrate by a preponderance of the evidence that an amount less than the HUD Rent (such as the actual monthly Rent received) reasonably reflected general market conditions applicable to the Rent Stabilized Unit(s) based on the physical location, physical condition, and/or amenities of the unit or property during all, or a portion, of the Base Year. (See example h.iii, below).
- ii. Factors. The Hearing Officer shall weigh the following factors in determining whether and to what extent a Respondent/Tenant

successfully challenged a presumptive recalculation of Base Year Gross Income:

- the Rent for other comparable units on the property or in other comparable properties;
- the physical condition of the unit(s), relative to other units on the property and/or comparable properties, which physical condition may reference the age, state of repair, or functionality of the structure including walls, flooring, and ceilings, the relative size and number of rooms in the unit(s) relative to other units on the property or comparable properties, unit appliances and amenities such as heating, air conditioning, and ventilation, laundry facilities, cooking and food preparation facilities, windows and screens, electrical and plumbing systems, security, the relative location of the unit(s) on the property, and any other physical aspect of the unit(s);
- shared services and amenities available to tenants of the unit(s) such as elevator(s), laundry or recreational facilities and equipment;
- the location of the property relative to other properties and/or community assets; and
- any other relevant information that may impact the Rent received or receivable for one or more units on the property during the Base Year.

f. Hearing Officer Discretion Limited. A Hearing Officer may conclude any of the following four outcomes applies to one or more of the units subject to a Petition for Upward Adjustment using this subsection (G)(3) of Chapter 6.

i. No Presumptive Recalculation. If the average monthly Rent received for a Rent Stabilized Unit in the Base Year equals or exceeds the HUD Rent for the most similar unit type based solely on number of bedrooms, then there will be no presumptive recalculation of Base Year Gross Income.

ii. Presumptive Recalculation Applicable. The presumptive recalculation shall be applied without modification if average monthly Rent for a Rent Stabilized Unit in the Base Year is less than the HUD Rent for the most similar unit type based solely on number of bedrooms, and a preponderance of the evidence supports a conclusion that the HUD Rent

more reasonably reflects general market conditions applicable to the unit and/or property. (See example h.ii, below.)

iii. Presumptive Recalculation Reduced. The presumptive recalculation shall be reduced if average monthly Rent for a Rent Stabilized Unit in the Base Year is less than the HUD Rent for the most similar unit type based solely on number of bedrooms, but a preponderance of the evidence supports a conclusion that an amount less than the HUD Rent (such as the actual Rent received) more reasonably reflects general market conditions applicable to the unit and/or property. (See example h.iii, below.)

iv. Presumptive Recalculation Increased. If a dispute exists whether the HUD Rent for the most similar unit type is an efficiency or one-bedroom unit, then the presumptive recalculation may be increased up to the average of the efficiency unit and one-bedroom unit HUD Rents, if a preponderance of the evidence supports a conclusion that an amount greater than the efficiency unit HUD Rent more reasonably reflects general market conditions applicable to the unit and/or property. (See example h.iv, below.)

g. Written Decision. Any Decision for a Petition for Upward Adjustment of Rent that utilizes this subsection (G)(3) must expressly discuss:

i. Optional Vega Adjustment Standard, Step 1. Whether average monthly Rent received for a Rent Stabilized Unit subject to the Petition was less than the HUD Rent for the most similar unit type based solely on the number of bedrooms; and if so

ii. Optional Vega Adjustment Standard, Step 2. Whether a preponderance of the evidence supports either using the presumptive recalculation of Base Year Gross Income (as described in subsection (G)(3)(f)(ii)), or revising the presumptive recalculation (as described in subsections (G)(3)(f)(iii) and (iv)), to ensure that Base Year Gross Income reasonably reflects the general market conditions applicable to the unit(s) and property in the Base Year. Any revision to the presumptive recalculation of Base Year Gross Income, as authorized by subsection (G)(3)(f), must discuss which factors support modification of the presumptive recalculation of Base Year Gross Income and include appropriate references to specific evidence in the record.

- h. Examples.
- i. Calculating Base Year Average Monthly Rent. If Unit X is an efficiency and was occupied from January 2015 through June 2015 for \$1,000 per month, was vacant in July 2015, and was occupied from August 2015 through December 2015 for \$1,110 per month, then the average monthly Rent received in the Base Year for Unit X would be \$11,550 divided by 11 months of occupancy. This equals the average monthly Rent of \$1,050 received in the Base Year.
  - ii. Presumptive Recalculation of Base Year Gross Income. Following Example (i), the average monthly Rent received for efficiency Unit X in the Base Year was unusually low because \$1,050 is less than \$1,213. Accordingly, for purposes of determining Base Year Net Operating Income for the property, \$11,550 would be subtracted from Base Year Net Operating Income; then the HUD Rent for the most similar unit type would be multiplied by the dates of occupancy (\$1,213 times 11 months equals \$13,343) and the sum would be presumptively added to Base Year Net Operating Income for a net increase of \$1,793.
  - iii. Challenging Presumptive Recalculation. Following Examples (i) and (ii), Respondent/Tenant demonstrates by a preponderance of the evidence that efficiency Unit X was significantly rehabilitated by replacing chipped paint, worn flooring, and functionally obsolete appliances with new paint, new flooring, and new appliances in July 2015, and so the \$1,000 monthly Rent received from January through June 2015 for Unit X might reasonably reflect general market conditions as applied to that unit. Therefore, the presumptive recalculation of Base Year Gross Income might only apply to the dates of occupancy after Unit X had been significantly rehabilitated. Therefore, Base Year Gross Income might be recalculated by subtracting actual Rent received from August through December 2015 ( $\$1,110 \times 5 = \$5,550$ ) and replaced with HUD Rents for that time ( $\$1,213 \times 5 = \$6,065$ ) for a net increase in Base Year Gross Income of \$515 (by subtracting \$5,550 actually received and then adding \$6,065 HUD Rent valuation to Base Year Gross Income).
  - iv. Hearing Officer Decision Regarding Presumptive Recalculation. Petitioner/Landlord demonstrates by a preponderance of the evidence that the property subject to a Petition contains three types of units: efficiency units comprised of 400 square feet of livable space, junior one-bedroom units comprised of 600 square feet of livable space, and one-bedroom units comprised of 800 square feet of livable space. Hearing

Officer acknowledges that junior one-bedroom units are most-similar to efficiencies based solely on the number of bedrooms, but concludes that the Base Year Gross Income should be increased for the junior one-bedroom units beyond the HUD Rent for efficiency units based on the relative square footage of the three unit types. Accordingly, the presumptive recalculation of Base Year Gross Income for junior one-bedroom units in the property may be calculated as the average between the HUD Rents for efficiency and one-bedroom unit types. Therefore, monthly Rent for a junior one-bedroom may presumptively be calculated as \$1,316 ( $\$1,213 + \$1,419 / 2$ ).

- i. [Allocation: *See Study Session 2 Staff Report.*]