



MEMORANDUM

Community Development Department
Rent Stabilization Program

DATE: February 22, 2021

TO: Rental Housing Committee

FROM: Patricia Black, Analyst II
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SUBJECT: Capital Improvement Petition Process Study Session

RECOMMENDATION

Receive background information and consider potential policy options related to a Capital Improvement Petition Process for Temporary Upward Adjustment of Rent.

BACKGROUND

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; and
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% Consumer Price Index – All Urban Consumers (CPI-U) (Bay Area Region);

2. Vacancy decontrol; and
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 that 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 of the CSFRA 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 RHC 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: (1) Specified Capital Improvement Petitions for Temporary Upward Adjustments of Rent; and (2) Joint Petition Between Property Owner(s) and Tenant(s). The RHC reviewed policy areas for the Capital Improvement Petition process as outlined below and gave direction to staff for future regulations (Attachment 1). 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 ownership records. 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 process which will be presented in regulations at a future RHC meeting.

Table 1: Policy Option Areas Discussed at January 25, 2021 RHC Meeting

Policy Option Area	Policy Options Determined	Further Discussion Requested
Area 1: Policy Basics	✓	
Area 2: Capital Improvement Petition Process	✓	
Area 3: Major Qualifications	✓	
Area 4: Categories and Authorized Expenses	✓	
Area 5: Documentation	✓	
Area 6: Share of Costs		✓
Area 7: Amortization and Sunset Periods	✓	
Area 8: Joint Petition Process	✓	

POLICY OPTION AREA FOR FURTHER REVIEW: AREA 6 – SHARE OF COSTS

The RHC requested staff review share of cost options further and provide policy recommendations with cost modeling reflective of the property size and ownership in Mountain View. After analyzing share of cost policies in peer jurisdictions, public input provided at community meetings and RHC meetings, and property records, staff proposed a three-tiered structure that takes into account property size, number of units impacted, and ownership records. No administrative processes are altered by this

structure, and all considerations can be built into supportive materials to reduce confusion for petitioners.

Staff proposes the RHC consider the following tier structure:

Property Type A

- One to five units
- Represents 43% of fully covered CSFRA properties
- Represents 7% of fully covered CSFRA units
- Consists of greatest number of owners with two or fewer properties

Property Type B

- Six to 20 units
- Represents 36% of fully covered CSFRA properties
- Represents 18% of fully covered CSFRA units
- Consists of large number of owners with three or fewer properties; increased number of corporate owners

Property Type C

- 21 or more units
- Represents 21% of fully covered CSFRA properties
- Represents 75% of fully covered CSFRA units
- Consists primarily of multi-property and/or corporate owners

Staff proposes the RHC consider the following policy options for share of costs based on tier structure:

Type A

- 100% of share of cost to tenants
- Increase capped at 10% and inclusive of Annual General Adjustment (AGA)
- Amortized according to Schedule B
- Sunsets at end of amortization period or at vacancy decontrol

Type B

- 75% of share of cost to tenants; 25% of share of cost to landlord
- Increase capped at 10% and inclusive of AGA
- Amortized according to Schedule B
- Sunsets at end of amortization period or at vacancy decontrol

Type C

- 50% of share of cost to tenants; 50% of share of cost to landlord
- Increase capped at 10% and inclusive of AGA
- Amortized according to Schedule B
- Sunsets at end of amortization period or at vacancy decontrol

Table 2: Overview of Proposed Share of Cost by Property Type

Property Type	Number of Properties	Number of Units	Proposed Share of Cost
Type A: 1 to 5 Units	299	1,081	100% (tenant); capped at 10% inclusive of AGA; amortized according to schedule; tenant hardship allowed
Type B: 6 to 20 Units	251	2,645	75% (tenant)/25% (landlord); capped at 10% inclusive of AGA; amortized according to schedule; tenant hardship allowed
Type C: 21 or More Units	143	11,124	50% (tenant)/50% (landlord) split, capped at 10% inclusive of AGA; amortized according to schedule; tenant hardship allowed

The RHC requested cost-modeling examples to further review the proposed policy recommendations. The following equation is used to determine the increase per affected unit per month:

$$\frac{[(\text{Total cost of capital improvement}) \times (\text{percent of cost-share})]}{\text{number of affected units} / \text{amortization period} / 12 \text{ months}}$$

In Model 1, a landlord needs to replace windows in units on their property at a cost of \$3,000 per unit. This model is based on a recent inquiry made by a property owner to CSFRA staff.

Table 3: Model 1 – Proposed Share of Cost for Replacement Windows by Property Type

Property Type	Total Cost of Repair	Number of Units Affected	Proposed Share of Cost	Increase per Affected Unit per Month
Type A: 1 to 5 Units	\$15,000	5	\$15,000 (total cost) / 5 (affected units) / 5 (amortization period) / 12 months	\$50 per month, temporary increase sunsets at the end of 5 years
Type B: 6 to 20 Units	\$30,000	10	\$30,000 (total cost) x 75% = \$22,500 / 10 (affected units) / 5 (amortization period) / 12 months	\$37.50 per month, temporary increase sunsets at the end of 5 years
Type C: 21 or More Units	\$90,000	30	\$90,000 (total cost) x 50% = \$45,000 / 30 (affected units) / 5 (amortization period) / 12 months	\$25 per month, temporary increase sunsets at the end of 5 years

In Model 2, a landlord is required to install fire sprinkler suppression systems in their units on their property at a cost of \$3,051 per unit. This model was requested by the RHC. Staff researched industry averages for costs of installing sprinklers in existing residential buildings, which is equivalent to a median of \$4.50 per square foot. Staff also researched the average square footage of one-bedroom apartments, which shows the average one-bedroom apartment in the United States is approximately 678 square feet. Staff modeled the costing scenario below utilizing the assumptions above.

Table 4: Model 2 – Proposed Share of Cost for Fire Suppression System/Sprinklers by Property Type

Property Type	Total Cost of Repair	Number of Units Affected	Proposed Share of Cost	Increase per Affected Unit per Month
Type A: 1 to 5 Units	\$9,153	3	\$9,153 (total cost) / 3 (affected units) / 20 (amortization period) / 12 months	\$12.71 per month, temporary increase sunsets at the end of 20 years
Type B: 6 to 20 Units	\$45,765	15	\$45,765 (total cost) x 75% = \$34,323.75 / 15 (affected units) / 20 (amortization period) / 12 months	\$9.53 per month, temporary increase sunsets at the end of 20 years

Property Type	Total Cost of Repair	Number of Units Affected	Proposed Share of Cost	Increase per Affected Unit per Month
Type C: 21 or More Units	\$305,100	100	$\$305,100 \text{ (total cost)} \times 50\% = \$152,550 / 100 \text{ (affected units)} / 20 \text{ (amortization period)} / 12 \text{ months}$	\$6.36 per month, temporary increase sunsets at the end of 20 years

FISCAL IMPACT

There are no associated increased costs as a result of this Study Session. The inclusion of the proposed petition processes may increase the number of upward adjustment petitions received by the RHC, resulting in increases in the costs associated with hearing processes.

PUBLIC NOTICING – Agenda posting.

PB-KMT-AVD/JS/6/CDD/RHC
 814-02-22-21M-1

- Attachments:
1. Policies Options for Capital Improvement Petition Process as Agreed to in January 25, 2021 RHC Meeting
 2. Draft Authorized Expenses and Amortization Schedules
 3. Cost-Recovery Mechanisms in Rent Stabilized Jurisdictions
 4. January 25, 2021 RHC Memo – RHC Study Session: Specified Capital Improvement Upward Adjustments
 5. August 24, 2020 RHC Memo – Draft Regulations Amending Chapter 6: Specified Capital Improvement Upward Adjustments
 6. CSFRA Regulations: Chapter 6
 7. CSFRA Regulations: Chapter 9