



## CITY OF MOUNTAIN VIEW

### MEMORANDUM

CSFRA, Community Development Department

**DATE:** March 26, 2018

**TO:** Members of the 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:** Annual General Adjustments Pre-February 2016 and Post-February 2017

### RECOMMENDATION

Consider the potential for and timing of any Annual General Adjustment applicable for time frames prior to February 2016 and after February 2017.

### SUMMARY

This staff report reviews past RHC AGA discussions, describes the legal purpose of an AGA, discusses the AGA authorized by the CSFRA, reviews the interconnection of the rent rollback and the AGA, and analyzes the potential for implementing an AGA for periods prior to February 2016. Of note:

- the required delay in implementation of the 2017 AGA (i.e. the percentage change in the CPI between February 2017 and the earliest implementation of the AGA on September 1, 2017) will be covered by the 2018 AGA;
- rents became regulated by the CSFRA on December 23, 2016 – the 2017 and 2018 AGAs will account for changes in the CPI since December 23, 2016; and
- if the RHC pursues an AGA for periods prior to the 2017 AGA, it could either rely on individual petitions, or identify a banked AGA that could be implemented at the earliest on September 1, 2018.

### BACKGROUND

The CSFRA required a rent rollback for certain tenancies. The CSFRA provides for two forms of rent increases: an Annual General Adjustment (AGA) authorized by CSFRA Section 1707, and a Petition for Upward Adjustment authorized by CSFRA Section

1710(a). The AGA is applicable to all Covered Rental Units while the petition process applies only to units specified in the petition.

On May 22, 2017, the RHC adopted Resolution No. RHC - 2 (attached to this report), identifying the AGA for 2017 to equal 3.4 percent, which was the percentage change in the consumer price index between February 2016 and February 2017 as published by the U.S. Department of Labor, Bureau of Labor Statistics (BLS). The RHC deliberated about AGA variations during its May 18, June 8, and November 6, 2017 meetings. Specifically, the RHC discussed the potential for an AGA that would reflect inflation prior to and/or after the 2017 AGA inflation period (February 2016 - February 2017).

As stated in the November 6, 2017 staff report, a pre-February 2016 AGA is not contemplated in CSFRA but the RHC could consider some form of adjustment based on its authority under CSFRA Section 1709(d)(1). At its November 6 meeting, the RHC adopted a motion directing staff to explore an undefined AGA gap period to be brought back to the RHC before June 2018.

## ANALYSIS

### Legal Purpose of an AGA

One purpose of the AGA is to efficiently counteract the effect of inflation over time to “take” a landlord’s profit.<sup>1</sup> The California Supreme Court recognized that if a “landlord’s profit remains the same year after year his return will in time diminish in real value: it is obvious that a \$ 1,000 ‘profit’ in 1990 will have a much lower value than the same dollar amount of profit in 1980.”<sup>2</sup>

An AGA *efficiently* counteracts inflation and so helps ensure landlords may earn a fair return by allowing a generally applicable increase for all regulated rental units based on economic conditions experienced in the last year. However, an AGA may not *effectively* counteract inflation and accommodate other landlord expenses, which vary for each landlord and each property from year to year. Individual petitions per landlord and per property effectively ensure that individual landlords may earn a fair return.

An AGA is efficient because one rule applies to every regulated rental unit while the petition process is effective because it facilitates individual analysis to ensure a fair return may be earned. Both the AGA and individual petitions are important components of legally regulating rent increases while ensuring that landlords may earn

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<sup>1</sup> See discussion in *Fisher v. City of Berkeley* (1984) 37 Cal. 3d 644, of the effect of inflation on landlord profit generally (at 682 - 684) and of one purpose of a general adjustment process (at 687 - 690).

<sup>2</sup> *Fisher* at 683.

a fair return. One challenge to create an AGA covering a period prior to February 2016 is to create one rule (or even a few rules) that apply broadly and are easy to administer, as further discussed below.

### The AGA authorized by the CSFRA

Section 1707 of the CSFRA, included as Attachment 1 to this report, provides that AGAs will reflect previous changes in the CPI over 12 months. There is no prospective AGA because there is no accurate forecast of how the CPI will change in the future. The CSFRA defines a lookback period based on the change in the CPI from March to March and then delays implementation of the increase until September 1, of each year.

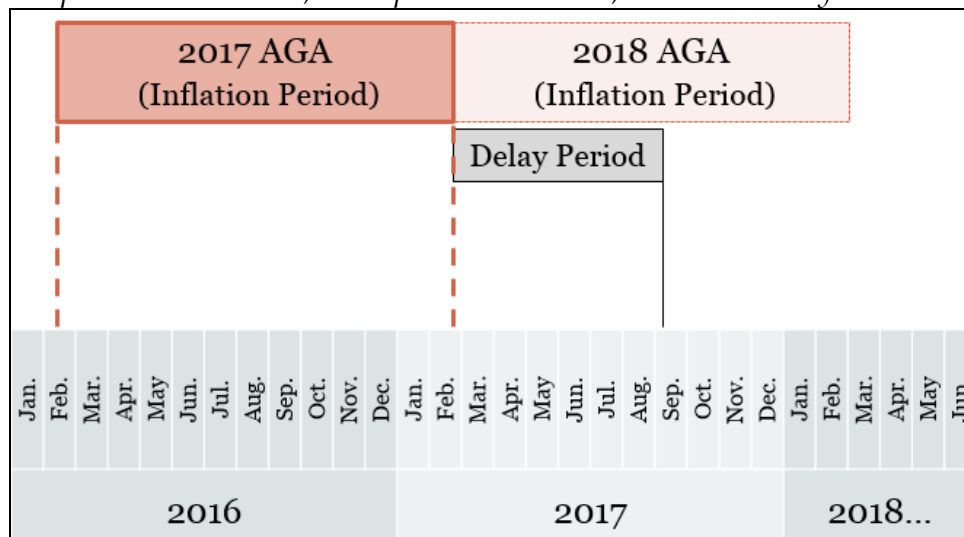
### **2017 AGA**

Again, the CSFRA strictly defines the parameters of how the AGA is calculated, when the AGA must be announced by the RHC, and the earliest date that the AGA may be imposed. For the 2017 AGA the RHC chose the twelve month period ending in February 2017 because the U.S. Department of Labor, Bureau of Labor Statistics (BLS) discontinued monthly publication of the identified inflation index. Landlords could have imposed the 3.4 percent increase as early as September 1, 2017.

### **2018 AGA**

Staff anticipates that the RHC will adopt a resolution identifying the 2018 AGA to equal the percentage change in an identified inflation index between February 2017 and February 2018. Accordingly, the 2018 AGA would capture economic changes that occurred after the 2017 AGA, including the period of delay required by the CSFRA (i.e. period between February and September 1, 2017). The inflation periods captured by the 2017 and 2018 AGAs, as well as the 2017 AGA delay are visualized in *Graphic 1*, below.

*Graphic 1: 2017 AGA, anticipated 2018 AGA, and 2017 Delay Period*



### The AGA and Rent Rollbacks

The interaction of the rent rollback and the AGA are complex. The AGA is one method to account for inflation and rising costs while rents are regulated. Arguably, the AGA should only capture the inflation and cost increases that occur while rents are regulated. The CSFRA began regulating rents effective December 23, 2016. The 2017 AGA accounts for changes in the CPI from the time rents became regulated through February 2017.<sup>3</sup> Changes in the CPI after February 2017 will be captured in the 2018 AGA.

However, another interpretation of the CSFRA concludes that it regulated rents prior to December 23, 2016 based on the rent rollback. Accordingly, the rent rollback is analyzed and the potential for an AGA applicable to periods prior to the 2017 AGA are each discussed below.

#### **The Rent Rollback authorized by the CSFRA**

Section 1702(b) and 1706 of the CSFRA required a rent rollback for some tenancies. Rent rollbacks are common components of new rent stabilization policies, reversing rent increases that would not have been imposed unless rent control was imminent.<sup>4</sup> First, tenancies that began after December 23, 2016 were unaffected by the rent rollback. Second, rents were only rolled back for tenancies if the rent was increased between October 19, 2015 and December 23, 2016. *Graphic 2* visualizes the two-step process to determine whether the rollback applied to a tenancy of a regulated rental unit.

*Graphic 2 Application of Rent Rollback by Date of Tenancy and Any Rent Increase*

<u>Date tenancy began</u>	<u>Did rent increase between 10/19/2015 - 12/23/2016?</u>	
Before 12/23/2016	<b>No</b> , no rent increase (e.g. no rent rollback)	<b>Yes</b> , rent was increased (rollback reversed rent increase)
After 12/23/2016	Not applicable (e.g. no rent rollback)	

First, if the rollback did not apply to the tenancy, then there is no need for a pre-2017 AGA because the landlord freely negotiated the rent when the CSFRA became effective. For example, if a tenancy began on October 1, 2015 and the landlord freely chose not to raise the rent, then there is no reason to provide the landlord with a pre-2017 AGA. The

<sup>3</sup> Notably, the 2017 AGA reflects changes to the CPI before rents were regulated on December 23, 2016, accounting for economic changes from February 2016 through February 2017.

<sup>4</sup> See e.g. *Oceanside Mobilehome Park Owners' Association v. City of Oceanside* (1984) 157 Cal. App. 3d 887, 905-908 (approving rollback of rents by 54 months plus AGAs) & *Berman v. Downing* (1986) 184 Cal. App. 3d Supp.1, 5-6 (approving rollback of rents by 4 months); see also CSFRA § 1701(n).

2017 AGA broadly accounts for economic changes that occurred as the CSFRA regulated rents.

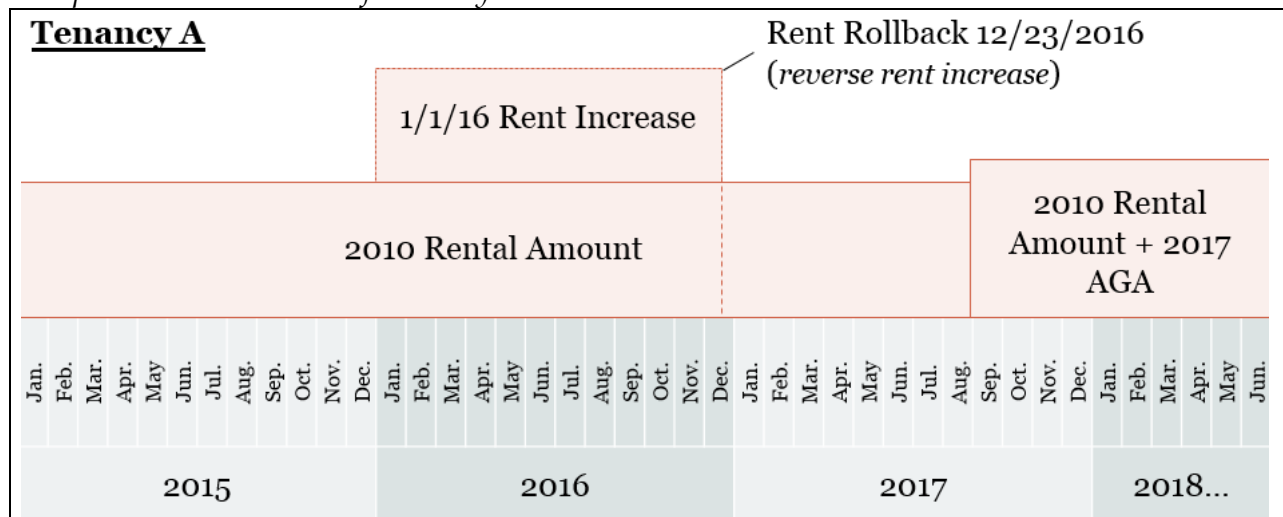
Second, setting aside tenancies unaffected by the rollback, there is likely significant variation among the tenancies with rollback rents. Among affected tenancies, every rent increase imposed between October 19, 2015 and December 23, 2016 was reversed by the rent rollback. However, we do not know the date when the landlord last set the rent. Staff presumes there will be significant variation in the last date that a landlord set the rent among landlords whose rent increases were rolled back.

This is important: to identify the inflation period or AGA required to relieve a landlord of the economic changes that may have reduced profit based on the rent rollback, the RHC must know the date of the second-to-last rent increase for tenancies with rollback rents. For example, compare three hypothetical tenancies in the same building:

A	Tenancy A began on January 1, 2010 where the only rent increase was implemented on January 1, 2016.
B	Tenancy B began on October 19, 2015 with a rent increase effective January 1, 2016
C	Tenancy C began on January 1, 2016 with a rent increase effective July 1, 2016.

The rent for each tenancy was effectively rolled back on December 23, 2016. However, the actual impact to the landlord was very different. The three tenancies, rent roll back, and 2017 AGA increase are visualized for each tenancy in *Graphics 3, 4, and 5*, below.

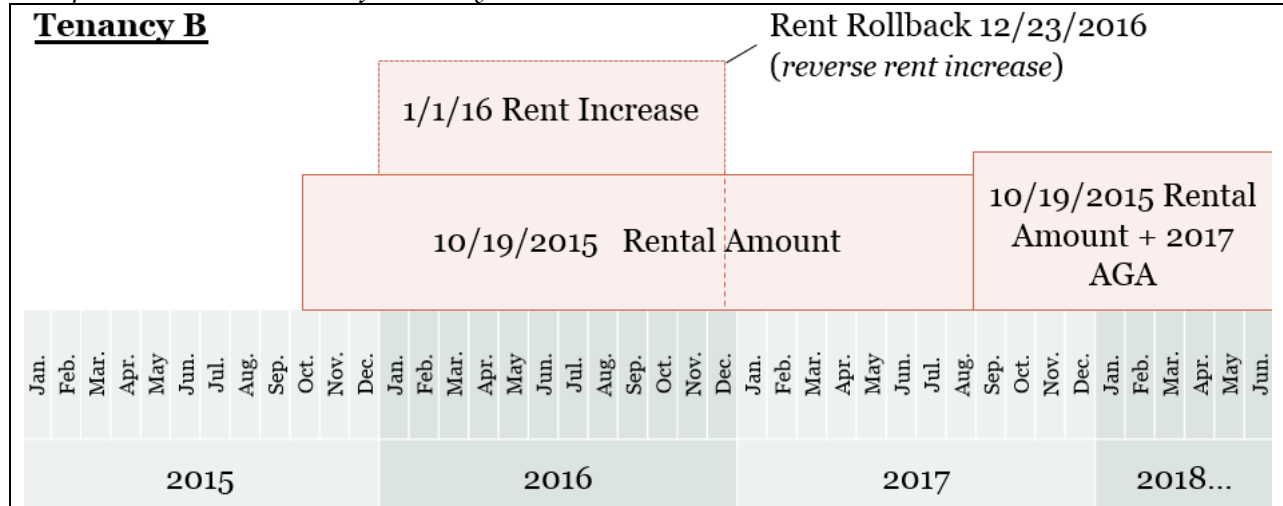
*Graphic 3 Visualization of Tenancy A*



Because the rent had not been increased for Tenancy A since 2010, an AGA that accounts for the effect of the rent rollback would account for change in CPI that occurred between January 2010 and February 2016. This result would provide a greater AGA for landlords that did not increase

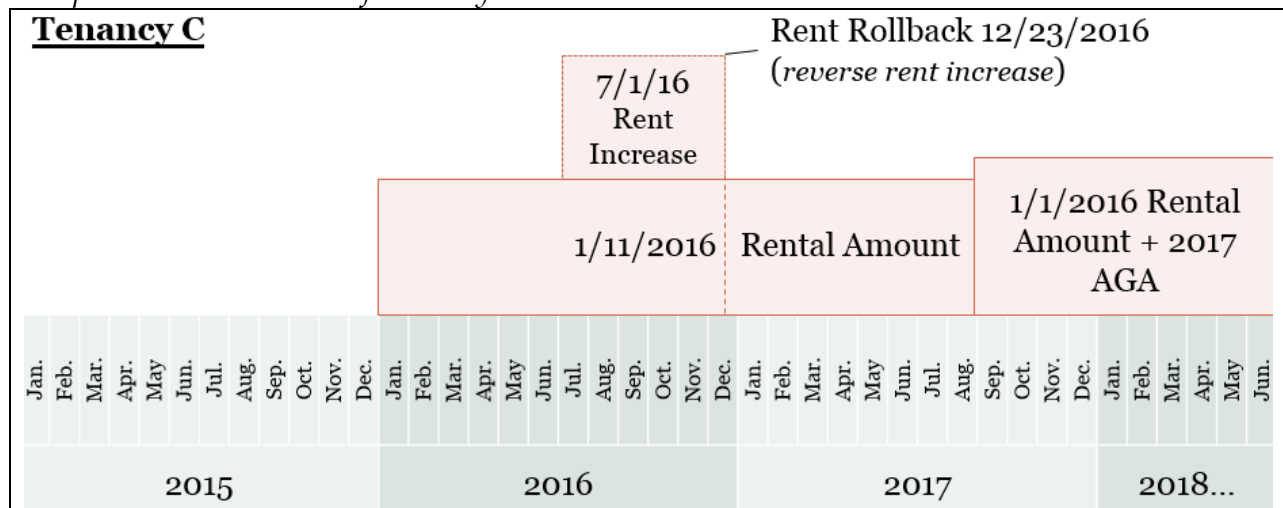
rents for long term tenants, but suddenly chose to increase rents after rent control was discussed on October 19, 2015.

*Graphic 4 Visualization of Tenancy B*

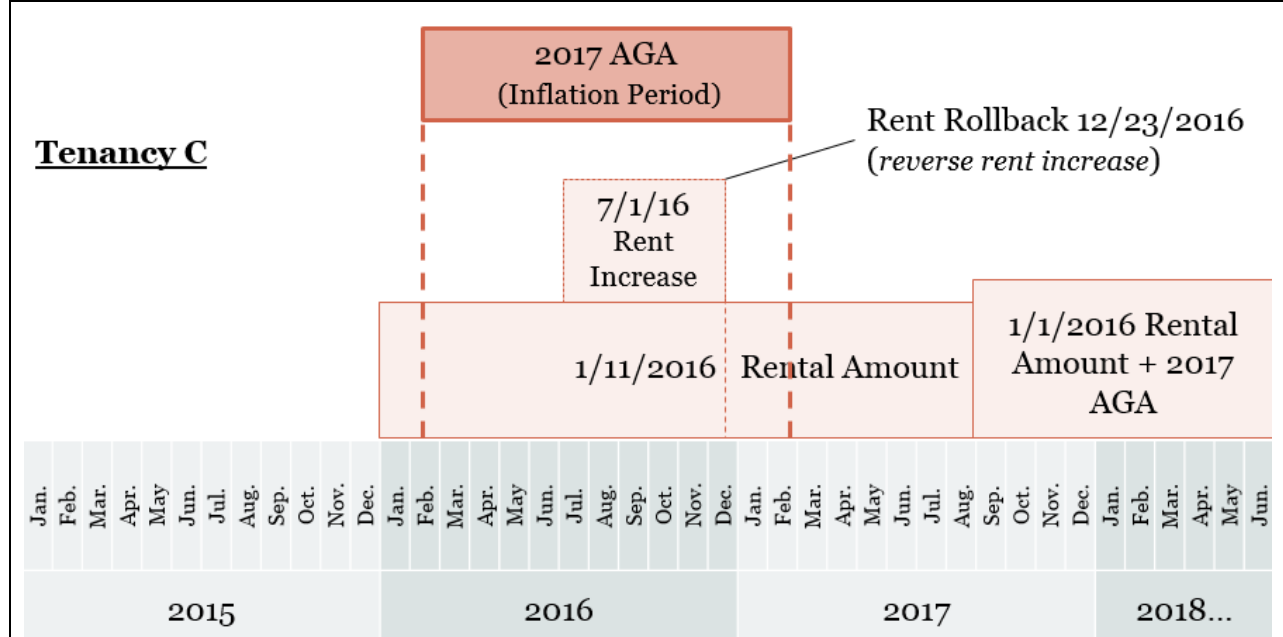


In contrast, the effective rollback for Tenancy B returned rents to the amount charged on October 19, 2015. An AGA that accounts for the effect of the rent rollback on Tenancy B would account change in CPI that occurred between October 2015 and February 2016. The percentage change in the CPI for this period is 0.6 percent, as identified in the November 6, 2017 staff report.

*Graphic 5 Visualization of Tenancy C*



Finally, the effective rollback for Tenancy C returned rents to the amount charged on January 1, 2016. An AGA that accounts for the effect of the rent rollback on Tenancy B would account for the change in CPI that occurred between January and February 2016. *Graphic 6*, below, overlays the inflation period of the 2017 AGA on the Visualization of Tenancy C.

*Graphic 6 Visualization of 2017 AGA with Tenancy C Rollback*

To summarize the hypothetical landlord with Tenancies A, B, and C in one building, such a landlord would require three different pre-2017 AGAs to effectively account for the economic impact of the rent rollback. Again, this conclusion follows the assertion that the date of the rolled-back rents should trigger an AGA, as compared to the date when rents became regulated. Notably, the regulation date is the same for all units (December 23, 2016) and the date of rolled-back rents is likely to vary significantly.

### Policy Proposal and Recommendation

As demonstrated by the hypothetical Tenancies A, B, and C, many tenancies would require individual calculations to provide a pre-2017 AGA. The pre-2017 AGA policy would then account for the percentage change in the CPI between February 2016 and the date to which rents were rolled back based on the second-to-last date of rent increase. The November 6, 2017 staff report noted that one policy option could provide a banked AGA for the period between October 2015 and February 2016, which equaled 0.6 percent. However, Tenancy C shows that even the October 2015-February 2016 inflation period would not accurately reflect changes in the CPI experienced prior to the 2017 AGA inflation period and the date to which rent was rolled back.

Because landlords may petition for an upward adjustment of rent regardless of the pre-February 2016 change in CPI, in light of the variations based on the length of tenancies and timing of rent increases that preclude a simple rule to capture changes in economic conditions prior to those captured by the 2017 AGA, and because the percentage change

in the CPI between October 2015 and February 2016 is only 0.6 percent, staff recommends that the RHC discontinue further deliberation of a pre-2017 AGA.

### **FISCAL IMPACT**

The adoption of an AGA applicable to periods prior to February 2016 is not anticipated to affect the budget of the RHC unless it spurs litigation.

### **PUBLIC NOTICING**      – Agenda posting

### **ATTACHMENTS**

1. Resolution No. RHC - 2 (2017)
2. Text of CSFRA Section 1707
3. November 6, 2017 Staff Report