

Rental Housing Committee  
**Tentative Appeal Decision**

Appeal No. 17180002

The Rental Housing Committee of the City of Mountain View (the "**RHC**") finds and concludes the following:

**I. Summary of Proceedings**

Lindsay Properties, LLC ("**Appellant-Landlord**") submitted a petition for upward adjustment of rent on December 22, 2017 applicable to 68 units (the "**Initial Subject Units**")<sup>1</sup>, all of which are located at 141 Del Medio Avenue (the "**Property**"). The Petition was accepted by RHC staff on January 4, 2018.

Notice of a pre-hearing settlement conference dated February 5, 2018 was delivered to Appellant-Landlord and residents of the Initial Subject Units; the settlement conference was scheduled for February 14, 2018 to be presided over by Hearing Officer Sandra DeLateur.

Residents of the Initial Subject Units, and the Del Medio Manor Tenants Association (an unincorporated association), submitted a response in opposition to the Petition dated February 12, 2018 via its authorized representative the Community Legal Services of East Palo Alto (the "**Respondent-Tenants**").

After the pre-hearing settlement conference, the Petition was assigned to Hearing Officer Jil Delasandro (the "**Hearing Officer**") and a hearing was scheduled for March 27, 2018.

Upon review of the Petition and documents from Respondent-Tenants, the Hearing Officer requested additional information from the Appellant-Landlord via a document dated February 28, 2018. The Hearing Officer also requested a pre-hearing telephonic meeting, which was scheduled for March 7, 2018.

After the pre-hearing telephonic conference, the Hearing Officer requested additional information from the Respondent-Tenants via a document dated March 7, 2018.

Appellant-Landlord submitted revised worksheets on April 4, 2018, which reduced the number of units for which a rent increase was sought from 68 to 56 (the "**Subject Units**").<sup>2</sup> The initial submission accepted by staff on January 4, 2018, as superseded by the April 4, 2018 submission is collectively referred to as the "**Petition**."

Respondent-Tenants submitted briefing materials and twenty tenant declarations in response to the Hearing Officer request.

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<sup>1</sup> The Initial Subject Units are: 101, 102, 105, 108, 109, 110, 112, 113, 115, 116, 117, 119, 121, 123, 124, 126, 127, 128, 130, 131, 132, 133, 135, 201, 205, 206, 208, 209, 210, 211, 213, 214, 215, 218, 219, 220, 222, 223, 224, 229, 230, 232, 233, 234, 235, 301, 304, 306, 307, 308, 309, 310, 312, 313, 314, 315, 317, 318, 319, 322, 324, 327, 328, 329, 331, 332, 333, and 334.

<sup>2</sup> The following Initial Subject Units were no longer proposed for rent increases in Appellant-Landlord's April 4, 2018 submission: 113, 116, 117, 124, 235, 306, 314, 317, 318, and 324. Accordingly, the Subject Units are: 101, 102, 105, 108, 109, 110, 112, 115, 119, 121, 123, 126, 127, 128, 130, 131, 132, 133, 135, 201, 205, 206, 208, 209, 210, 211, 213, 214, 215, 218, 219, 220, 222, 223, 224, 229, 230, 232, 233, 234, 301, 304, 307, 308, 309, 310, 312, 313, 315, 319, 322, 327, 328, 329, 331, 332, 333, and 334.

The Hearing Officer presided over a public hearing on May 22, 2018, in which the Appellant-Landlord and Respondent-Tenants participated. The May 22, 2018 hearing was recorded and is available as a part of the administrative record.

At the conclusion of the hearing, the Hearing Officer requested additional information from both the Appellant-Landlord and Respondent-Tenants and left the record open. Additional documentation was received and the hearing record was closed on June 13, 2018.

The Hearing Officer decision dated July 5, 2018 was delivered on or about July 16, 2018 and included an amendment to the original decision (collectively, the "**Decision**").

A timely appeal of the Decision was received from Appellant-Landlord on July 20, 2018. A timely appeal of the Decision was also received from Respondent-Tenants on July 24, 2018.

## **II. Procedural Posture**

CSFRA section 1711(j) states in part that "[a]ny person aggrieved by the decision of the Hearing Officer may appeal to the full Committee for review." Regulation Chapter 5 section H(5)(a) provides that the RHC "shall affirm, reverse, or modify the Decision of the Hearing Officer, or remand the matters raised in the Appeal to a Hearing Officer for further findings of fact and a revised Decision" as applicable to each appealed element of the decision.

## **III. Appealed Elements of Hearing Officer Decision**

Regulation Chapter 5 section H(1)(a) states that "[t]he appealing party must state each claim that he or she is appealing, and the legal basis for such claim, on the Appeal request form." Section III of this Tentative Appeal Decision identifies the elements of the Decision that are subject to appeal by (A) the Appellant-Landlord, and (B) the Respondent-Tenants. The Tentative Appeal Decision regarding each appealed element is provided in Section IV of this Tentative Appeal Decision.

### **A. Appellant-Landlord Appeal Elements**

The Appellant-Landlord claims, "the Decision fails to provide the property owner a fair rate of return as required by the CSFRA." Specifically, the Appellant-Landlord contests four elements of the Decision: (1) the requested Vega Adjustment, (2) the calculation of adjusted gross income, (3) exclusion of specified expenses, and (4) the allocation of the upward adjustment of rents. Relevant information from the Petition, Decision, and appeal for each contested element is provided below.

In addition to the appeal elements detailed below, the Appellant-Landlord states, "[A] second reason for our appeal is the failure of the city and the hearing officer to adhere to the timelines set forth by the RHC." The Appellant-Landlord expresses frustration regarding alleged delays, inconsistencies, and errors in process, concluding that the Decision should have been rendered on July 5, 2018 but was actually delivered on July 16, 2018.

## 1. Vega Adjustment

Petition worksheets<sup>3</sup> 1A and 2.1 provide relevant information for the Appellant-Petitioner's request for a Vega Adjustment pursuant to Regulation Chapter 6, Section G.<sup>4</sup> Worksheet 1A identifies five unit types, as described in the table below.

<b>Table 1 Unit Types &amp; Requested Vega Adjustments</b>		
<b>Unit Type</b>	<b>Square Footage</b>	<b>Vega Adjustment (request / total units)</b>
Studio	520 sf	11 / 22
Junior 1-Bedroom	611 sf	44 / 58
Small 1-Bedroom / 1 Bath	734 sf	5 / 15
Large 1-Bedroom / 1 Bath	933 sf	0 / 3
2-Bedroom / 1 Bath	1,080 sf.	3 / 3
Total Units		63 / 104

As summarized above, Worksheet 2.1 requests a Vega Adjustment for 63 rental units, including 24 units that are not Subject Units.<sup>5</sup> Vega Adjustments were requested for 3 of 3 two-bedroom units, 11 of 22 studios, 44 of 58 junior one-bedroom units, and 5 of 15 small one-bedroom units (no Vega Adjustments were requested for the 3 large one-bedroom units).

As detailed in Section IV(A)(1), the Decision concluded that Respondent-Tenants successfully contested the presumption that the Appellant-Landlord would be entitled to a Vega Adjustment. The Decision also concluded that junior 1-bedroom units should be considered "efficiencies" for purposes of Regulation Chapter 6 Section G(3)(a), and not be valued as 1-bedroom units when comparing average base year rents with fair market rents published by the U.S. Department of Housing and Urban Development.

Appellant-Landlord appeals the conclusion of the Decision that Respondent-Tenants rebutted the presumption that the Appellant-Landlord is entitled to a Vega Adjustment. The Appellant-Landlord cites prior submissions, including the Petition and other submitted documentation, to argue that the location, physical condition of the units, and housing services available to Respondent-Tenants cannot adequately overcome the presumption in favor of a Vega Adjustment. Appellant-Landlord also appeals the conclusion that junior 1-bedroom units should be considered efficiencies for purposes of Regulation Chapter 6 Section G(3)(a), and argues that junior 1-bedrooms should be valued as 1-bedrooms because they are 90 square feet larger than on-site studio units, have a "heavy mobile divider that creates 2 separate rooms," and have been considered "junior 1-bedrooms" by the Appellant-Landlord for almost 50 years.

<sup>3</sup> Although substantially the same documents, worksheet numbers have changed since submission of the Petition. All references in this Tentative Appeal Decision to worksheet numbers and lines refer to the Petition.

<sup>4</sup> Worksheet 2.1 was initially submitted on 12/22/17 and was not altered by Petitioner-Landlord in the 4/4/18 submission.

<sup>5</sup> The requested Vega Adjustments for rental units that are not Subject Units is discussed in Section IV.A.2.

## **2. Adjusted Gross Income in the Base and Petition Years**

Petition worksheets 2 and 2.1 provide relevant information regarding calculation of gross income in the base and petition years pursuant to Regulation Chapter 6, Section D.<sup>6</sup>

After concluding that a Vega Adjustment was not warranted, the Decision identifies the adjusted gross income in the base and petition years to be \$1,662,979.00 and \$1,837,472.20.

Appellant-Landlord appeals the calculation of adjusted gross income. Specifically, Appellant-Landlord argues that calculating "'rents that are lawfully collectible' vs 'rents that were actually collected' effectively penalizes the landlord twice for having a vacancy."<sup>7</sup> The Appellant-Landlord does not explain how or why the actual calculation of adjusted gross income described in the Decision is in error or to what degree, if any, Appellant-Landlord was harmed. Appellant-Landlord does not further define what the adjusted gross income should be in the base year or petition year beyond the figures included in the Petition.

## **3. Exclusion of Specified Expenses**

Petition worksheet 3 addresses operating expenses. Appellant-Landlord identifies four line items/specified expenses that were excluded from expenses when calculating operating expenses for purposes of calculating net operating income in the Decision. Each line item/specified expense that is subject of appeal is identified below (the second and third items are discussed in one section based on the discussion of the issues in the Decision).

### **a. Business License Fees – California Apartment Association Fees**

Line 2 of Petition worksheet 3 allows petitioners to identify business license fees. The Petition itemizes business license fees totaling \$3,588.79 in the base year and \$12,522.07 in the petition year.

The Decision excludes from the petition year operating expenses \$1,080.05, as (1) an expense that was refunded pursuant to Regulation Chapter 6, Section E(2)(d), and (2) an improper lobbying expense pursuant to Regulation Chapter 6, Section E(2)(j). The check register detail report dated 11/15/2017 and submitted by Appellant-Landlord with the Petition on 12/22/2017 identifies an expense of \$860.25 as a "Membership Renewal" for the California Apartment Association ("CAA") (Evidence Exhibit A).

Appellant-Landlord states that fees paid to the CAA were improperly disqualified as an operating expense in the Decision because the CAA "provide lease forms, training, vendor certification, and legal assistance" and "have nothing to do with 'lobbying expenses[.]'"

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<sup>6</sup> The form worksheet 2 and the information submitted by Appellant-Landlord for worksheet 2 changed between the 12/22/17 and 4/4/18 submissions. The Decision uses information from the 4/4/18 submission of worksheet 2, which element of the Decision is not appealed by the Appellant-Landlord.

<sup>7</sup> Notably, worksheet 2 was revised between the 12/22/17 submission and 4/4/18 submission to clarify the proper calculation of adjusted gross income in line 5. The worksheet revision does not appear to have altered or otherwise impacted the calculation in the Decision of adjusted gross income in the base year; petition year adjusted gross income is discussed separately in Section IV of this Tentative Appeal Decision.

b. Management Expenses

Line 7 of Petition worksheet 3 allows petitioners to summarize management expenses for the base and petition years, which expenses may be itemized in worksheet 3.2 (*see* Regulation Chapter 6, Section E(1)(f)).

For the base year, both Petition worksheets 3 and 3.2 list management expenses as one item totaling \$71,709; worksheet 3.2 states: "Management Services (see Bank Statements & Invoices)." For the petition year, worksheet 3 lists management expenses as \$111,397.80; worksheet 3.2 clarifies that the figure listed in worksheet 3 is six percent of gross income. Actual management expenses for the petition year are listed on worksheet 3.2 as one item totaling \$138,379.29.

The Decision cites Regulation Chapter 6, Section E(1)(g) and concludes that the evidence fails to support an exception to the presumption that management expenses should be no more than six percent of gross income, "unless it is established that such expenses do not exceed those ordinarily charged by commercial management firms for similar residential rental properties."

Appellant-Landlord states that the categorization of management expenses are not consistent with industry standards and notes that "the hearing officer indicates that the landlord failed to meet its burden of proof as to fees that were eligible to be paid or reimbursed. However, she requested and received copies of every cancelled check, invoice, and bank statement and therefore had access to every piece of evidence to prove expenses." Appellant-Landlord concludes that disallowing expenses "that are clearly management related prevents the owner from receiving a fair rate of return."

c. Costs for Ordinary Repair, Replacement, and Maintenance - Salaries

Line 6 of Petition worksheet 3 allows petitioners to summarize costs for ordinary repair, replacement, and maintenance for the base and petition years, which costs may be itemized in worksheets 3.1A and 3.1B (*see* Regulation Chapter 6, Section E(1)(f)).

For the base year, Petition worksheet 3 lists ordinary repair, replacement, and maintenance costs as totaling \$333,782.62. That sum is broken into thirteen categories in worksheet 3.1A, including line item 12, which is identified as "Salaries" benefitting all units totaling \$180,732.13. The detailed description of line item 12 in worksheet 3.1A lists two entries: check number 8726, dated 1/5/15, for \$24.30; and "Employee Compensation – General Ledger Entries," which is undated, for \$180,707.83.

For the petition year, Petition worksheet 3 lists ordinary repair, replacement, and maintenance costs as totaling \$358,811.13. That sum is broken into thirteen categories in worksheet 3.1B, including line item 12, which is identified as "Salaries" benefitting all units totaling \$215,505.92.

The Decision states that "salary costs must be properly re-categorized as management expenses in both [base and petition] years and appear to be duplicative [of management expenses]." The Decision further states that Appellant-Landlord failed to meet the burden of proof to distinguish between salaries as a component of ordinary repair, replacement, and maintenance costs versus management expenses, and notes the lack of time records and lack of proof of work performed. The Decision states that "none of the employees appear to have contractor or other relevant licenses."

Appellant-Landlord appeals the disqualification of salaries as ordinary repair, replacement, and maintenance costs, arguing that the burden of proof is excessive and

unrealistic. Appellant-Landlord states that one licensed contractor (a refrigeration technician) is on staff and that the "hearing officer would demand that each maintenance staff employee have certifications and licenses in multiple areas which is not required by state law or necessary to perform their jobs." Appellant-Landlord further states that owners do not keep time records and that hundreds of hours of work were excluded, including work necessary to complete the Petition. Appellant-Landlord states that job descriptions, salaries, paychecks, and work orders were submitted for a two-year period and the exclusion of salaries prevents the landlord from receiving a fair rate of return.

d. Capital Improvements

Line 8 of Petition worksheet 3 allows petitioners to summarize amortized capital improvement costs for the base and petition years, which costs may be itemized in worksheet 3.3 (*see* Regulation Chapter 6, Section F).

For the base year, Petition worksheet 3 lists amortized capital improvement costs as totaling \$18,538.38. That sum is divided into three line items in worksheet 3.3, as shown below.

**Table 2 Base Year Capital Improvement Line Items**

<u>Description</u>	<u>Units Affected</u>	<u>Initial Cost</u>	<u>Amortization</u>	<u>Annual Cost</u>
Common area pavers	All	\$ 49,250.00	10 yrs	\$ 4,925.00
Roof replacement	All	\$ 114,952.00	10 yrs	\$ 11,495.20
Elevator	All	\$ 42,363.69	20 yrs	\$ 2,118.18
subtotal				<b>\$ 18,538.38</b>

For the petition year, Petition worksheet 3 lists amortized capital improvement costs as totaling \$23,016.57. That sum is divided into two line items in worksheet 3.3: resurface parking lot, affecting all units, with an initial cost of \$44,781.88 amortized over ten years for an annual cost of \$4,478.19; and ongoing capital improvement costs from the base year, with an annual cost of \$18,538.38 for an undisclosed number of years.

The Decision excluded from capital improvements the cost of common area pavers in the base year, finding that Appellant-Landlord "provided no evidence that the common area pavers were a necessary cost rather than an unnecessary overimprovement" in accordance with Regulation Chapter 6, Section F(2)(d). The Decision reduced eligible capital improvement costs in the base year to \$14,699.02. The Decision states that Appellant-Landlord "failed to meet its proof burden with regard to the \$14,000 elevator expense in the Petition Year and said expense is excluded, reducing Petition Year Capital Expense to \$ 9,016.57."

Appellant-Landlord appeals the exclusion of the paver costs, arguing that evidence in the record reflects that the installation was necessary due to deterioration of electrical circuitry under the pool deck, which was replaced in three phases over four years. Appellant-Landlord also states that walkways were replaced to address "tripping hazards." Appellant-Landlord further argues that that discussion of the parking lot resurfacing in the Decision was unsupported by evidence.

#### **4. Allocation of Upward Adjustments**

Line 6 of worksheet 5 of the Petition provides for the "allowed rent increase per unit," which is calculated by dividing the allowed monthly rent increase to maintain net operating income by the total number of units on the property in accordance with Regulation Chapter 6, Section J. The final columns of worksheet 1A of the Petition allow petitioners to propose allocation of any allowable rent increase available via the petition process.

Line 6 of worksheet 5 of the Petition anticipates the property will be eligible for a per-unit, per-month increase of \$136.85. The final columns of worksheet 1A of the Petition propose rent increases on 56 Subject Units ranging from \$115 to \$490 per month, with a mean (average) increase of \$254.29 per Subject Unit per month and median increase of \$245 per Subject Unit per month.

The Decision allocates an increase equally across all units, which amount is based on the maintenance of net operating income methodology. The Decision cites the general rules found in Regulations Chapter 6, Sections J and G(3)(e). The Decision further states, "since Landlord admits that it does not charge expenses to any specific unit, but charges expenses across all of them, the same should apply to any rent increases under the Act" (citing Appellant-Landlord submission on worksheet 6 of the Petition).

Appellant-Landlord appeals the even allocation of rent increases, arguing that rent increases should only apply to tenants whose tenancies began prior to the effective date of the CSFRA. Appellant-Landlord argues that tenants whose tenancies began after the effective date of the CSFRA are already paying market rate rents, and so allocating increases to those units "would raise their rents above market rates and likely drive them away from Del Medio Manor to other properties."

#### **B. Respondent-Tenant(s) Appeal Elements**

Respondent-Tenants state: "While the majority of the Hearing Officer's decision is consistent with the evidence presented by the parties, four of the findings therein are not supported by the record and must be modified by the Rental Housing Committee." Each of the four elements appealed are described below.

In addition to the appeal elements detailed below, the Respondent-Tenants appear to appeal the validity of two regulations adopted by the RHC. Specifically, Respondent-Tenants assert that the following sections of the regulations "unlawfully contradict the purpose and provisions" of the CSFRA: Regulation Chapter 6, Section C(4) (defining the "Consumer Price Index" applicable for maintenance of net operating income calculations) and Section G(3)(a) (defining the Vega Adjustment standard to rebut the presumption that base year net operating income provided a fair return to property owners). Any appeal to the RHC challenging the validity of regulations adopted by the RHC pursuant to its authority under the CSFRA are denied as improper.

#### **1. Calculation of Adjusted Gross Income in the Petition Year**

Respondent-Tenants appeal the calculation of adjusted gross income in the petition year, and assert that the Decision found that adjusted gross income in the petition year was \$19,157.80 less than the total gross income identified in line 2 of worksheet 2 of the Petition. Respondent-Tenants argue that the evidence does not support the calculation included in the Decision and

assert that the adjusted gross income in the petition year must be increased by \$7,126.14 "to account for unimplemented annual general adjustments."

**2. Calculation of Base and Petition Year Costs for Ordinary Repair, Replacement, and Maintenance Due to the Exclusion of Salaries**

Respondent-Tenants argue that exclusion of salaries from the ordinary repair, replacement, and maintenance costs is "supported by substantial evidence" but appeal the calculation of ordinary repair, replacement and maintenance costs in the base and petition years. Respondent-Tenants state that the calculation of ordinary repair, replacement, and maintenance costs in both the base and petitions years is "unsupported by any evidence in the record" and "must be modified to no more than the following amounts: \$153,050.49 (base year) and \$143,305.21 (petition year).

**3. Calculation of Base and Petition Year Costs for Ordinary Repair, Replacement, and Maintenance Due to Reimbursable Costs**

Respondent-Tenants further appeal the calculation of ordinary repair, replacement and maintenance costs in the Decision for the base and petition years, due to an assumption that an unidentified portion of expenses in both base and petitions years should have been excluded because they were reimbursed or eligible for reimbursement. Respondent-Tenants cite Regulation Chapter 6, Section E(2)(d), which states in part that "expenses for which the Landlord has been or was eligible for reimbursement by another party, whether or not reimbursement was actually received" shall not be included in operating expenses.

Specifically, Respondent-Tenants identify two purported line items in the base and petitions years, and argue that the Decision appears to include the items from an unspecified document for in ordinary repair, replacement and maintenance costs without substantial evidence to support the inclusion of those costs. In support of its claim, Respondent-Tenants cite evidence that, "the Landlord's witness confirmed that cleaning expenses are generally recovered from tenant deposits." The two appealed line items are summarized below.

**Table 3 Appealed Expense Items**

<b><u>Line Item</u></b>	<b><u>Base Year</u> (\$)</b>	<b><u>Petition Year</u> (\$)</b>
Cleaning Expenses	2,130.00	2,320.00
Turnover Expenses	14,199.75	46,211.83

**4. Calculation of Petition Year Operating Expenses**

Respondent-Tenants further appeal the calculation of operating expenses in the Decision for the petition year, stating that specified expenses were not supported by evidence in the record. Specifically, Respondent-Tenants cite an allegedly double-counted \$1,100 check to P.W. Stephens Environmental, as well as other expenses referenced in section B.7 of Respondent-Tenants Supplemental Letter Brief after Hearing dated June 4, 2018 (Evidence Exhibit M). Section B.7 of Exhibit M refers, in turn, to various attachments and responses in the record.



#### **IV. Tentative Decision Regarding Appealed Elements**

Both Appellant-Landlord and Respondent-Tenants have appealed some of the same elements of the Decision, which require evaluation and calculation of income and expenses in the base and petitions years. Each appealed element of the Decision is discussed below.

##### **A. Vega Adjustment**

Although the Vega Adjustment is one element of the Decision, resolution of the appeal of the Decision regarding the Vega Adjustment requires analysis of the individual components of the Decision related to the Vega Adjustment, including: the conclusion that junior one-bedroom units should be valued as efficiencies, and the overall conclusion that the physical and market conditions of the property and individual units do not merit a Vega Adjustment. In addition, a discrepancy exists between the units for which a Vega Adjustment was sought and the units for which a rent increase was sought, which raises a question regarding the validity of a Vega Adjustment for units that are not subject to the Petition. Each issue is discussed below.

##### **1. Valuation of Junior One-Bedroom Units**

The Decision addresses the application of the Vega Adjustment to junior one-bedroom units. The Decision rejected the request in the Petition that the one-bedroom valuation (\$1,419) be applicable to junior one-bedroom units. The Decision cites information in the Petition indicating that Appellant-Landlord believes the market value of a junior one-bedroom unit to equal \$2,000 per month, which is more similar to the Appellant-Landlord's valuation of a studio (\$1,900/month) than the valuation of a small one-bedroom (\$2,400/month). The Decision further cites the physical condition of junior one-bedrooms as containing one room, with an attached bath, where the main room includes an "accordion door" that does not reach from the ceiling to the floor. The Decision also cites that if the accordion door is in use, "one must pass through the 'bedroom' area of the main room to enter the bathroom."

The Decision concluded that junior one-bedroom units should be valued as efficiencies for purposes of Regulation Chapter 6, Section G(3)(a). Substantial evidence supports the conclusion that junior one-bedrooms are more similar to an efficiency than a one-bedroom unit, including the physical description and pictures of the partition submitted by Respondent-Tenants within tenant declarations (Evidence Exhibit D), and the comparison of Appellant-Petitioner's valuation of studio, junior one-bedroom, and small one-bedroom apartments at the subject property (Evidence Exhibit A). Accordingly, the conclusion that junior one-bedroom units shall be valued as efficiencies for purposes of Regulation Chapter 6, Section G(3) is **affirmed**.

Of the 44 junior one-bedroom units for which Appellant-Landlord sought a Vega Adjustment, average monthly rent for 13 units was below the Vega Adjustment standard for efficiencies and rent for 31 units equaled or exceeded the Vega Adjustment standard for efficiencies.<sup>8</sup> To the extent any Vega Adjustment is warranted for the property, it shall not apply to the 31 junior one-bedroom units for which average monthly rents received in the base year equaled or exceeded \$1,213. Accordingly, the Petition must be interpreted to request a Vega Adjustment for 32 of 104 units.

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<sup>8</sup> As shown in Appendix A, average monthly rents for units 108, 109, 120, 131, 208, 209, 211, 231, 233, 301, 309, 327, and 333 were less than \$1,213 per month of occupancy in the base year.

## 2. Discrepancy between Units Subject to Proposed Rent Increase and Units Subject to Vega Adjustment

Although the Petition requested Vega Adjustments for 63 of 104 units, the request for Vega Adjustments does not align with the units for which a rent increase is sought. In other words, the Petition initially requested Vega Adjustments for 63 units, but sought rent increases for 56 Subject Units regardless of whether a Vega Adjustment was requested for those same Subject Units. Specifically, the Petition sought Vega Adjustments for 24 units for which a rent increase was not sought.<sup>9</sup> Because no rent adjustment is sought for 24 units for which a Vega Adjustment was requested, the tenants of those units were not included in the petition, hearing, or appeal process and so those 24 units must also be excluded from the Petition, to the extent any Vega Adjustment is warranted for the Property.

However, 14 of the 24 units for which a Vega Adjustment but not a rent increase was sought are also junior one-bedrooms for which a Vega Adjustment is not applicable under this Tentative Appeal Decision. Therefore, only 10 of the 24 units must be excluded from the Appellant-Landlord's request for Vega Adjustments because the tenants were not included in the Petition, hearing, or appeal process. As described in the preceding paragraphs, the Petition must be interpreted to request a Vega Adjustment for 22 of the 56 Subject Units. Table 4 below provides relevant information for the Vega Adjustment of the 22 Subject Units.

## 3. Application of Vega Adjustment

Regulation Chapter 6, Section G(1) creates a rebuttable presumption that net operating income produced by a property during the base year provided a fair return on investment for the property. Chapter 6, Sections G(2) and G(3) provide that a landlord will have rebutted the presumption that base year net operating income provided for a fair return if the average monthly rent received during the occupancy of a rent stabilized unit in the base year was less than fair market rents published by HUD for the most similar unit type based on the number of bedrooms.

Appellant-Landlord successfully rebutted the presumption that net operating income produced by the property provided for a fair return because the average monthly rent during occupancy in the base year for the twenty-two units listed in the table below was less than the applicable HUD fair market rents.

**Table 4 Vega Adjustment**

<u>Unit #</u>	<u>Unit Type</u>	<u>Rent Rec'd</u> ( <u>\$</u> )	<u>Vega Adjusted</u> <u>Income</u> ( <u>\$</u> )	<u>Difference</u> ( <u>\$</u> ) <i>Vega Adjustment. less Rent Received</i>
108	Jr. 1-Bdrm	13,700	14,556	856
109	Jr. 1-Bdrm	13,760	14,556	796
110	2-Bdrm	20,400	21,708	1,308
131	Jr. 1-Bdrm	14,400	14,556	156
132	Efficiency	13,900	14,556	656
135	Efficiency	13,500	14,556	1,056

<sup>9</sup> As shown in Appendix A, a Vega Adjustment was requested for the following units but no rent increase was sought for those units: 103, 116, 118, 120, 122, 124, 125, 202, 204, 212, 226, 228, 231, 235, 303, 305, 306, 311, 318, 320, 321, 325, 330, and 335.

206	Sm. 1-Bdrm	16,300	17,028	728
208	Jr. 1-Bdrm	13,900	14,556	656
209	Jr. 1-Bdrm	13,900	14,556	656
210	2-Bdrm	19,100	21,708	2,608
211	Jr. 1-Bdrm	14,400	14,556	156
219	Sm. 1-Bdrm	16,635	17,028	393
224	Efficiency	14,040	14,556	516
233	Jr. 1-Bdrm*	14,060	14,556	496
234	Efficiency	14,015	14,556	541
301	Jr. 1-Bdrm	13,800	14,556	756
309	Jr. 1-Bdrm	14,395	14,556	161
310	2-Bdrm	20,300	21,708	1,408
319	Sm. 1-Bdrm	16,650	17,028	378
327	Jr. 1-Bdrm	14,520	14,556	36
333	Jr. 1-Bdrm	13,725	14,556	831
334	Efficiency	13,725	14,556	831
Presumptive Vega Adjustment (expressed as an increase to base year gross income)				<b>15,979</b>

\* Unit type is contested.

However, Respondent-Tenants contested the recalculation of base year gross income based on the physical and market conditions of the property and individual units pursuant to Regulation Chapter 6, Section G(3)(d).

The Decision concludes that the Appellant-Landlord is not entitled to a Vega Adjustment because "a preponderance of the evidence supports a rebuttal to any presumption" in favor of a Vega Adjustment. The Decision quotes an excerpt of Regulation 6(G)(3)(d), noting that the physical and/or markets conditions relating to the property or any individual unit may demonstrate that a recalculation of Base Year Gross Income: is unnecessary for the landlord to receive a fair rate of return, fails to ensure fairness, or is otherwise contrary to the purposes of the CSFRA.

In support of its conclusion that the Appellant-Landlord is not entitled to a Vega Adjustment, the Decision discusses the following property- and unit-specific conditions. First, the Decision cites the location of the property. The property is adjacent to Caltrain and a lumberyard; noise, vibrations, and odors affect the property from trains, heavy machinery, and the operation and idling of large vehicles related to each adjacent use.

Second, the Decision cites the general condition of individual units. The Decision states, "evidence shows that new tenants (not the subjects of this Petition) live in remodeled units, with new kitchens, some bathrooms, and new flooring." However, the Decision states that the Subject Units "have not been remodeled," contain "worn carpets, minimal outdated heating" and "faulty plumbing, no air conditioning, and leaking pipes." The Decision further states, "some units have balconies" but that the evidence "show apparent structural deficiencies, such as wood pulling away from the wall, cracked and aging wood, and in some cases, dry rot."

Finally, the Decision cites available housing services. The Decision states, "some of the facilities listed in the Petition such as covered parking and storage units are available only for some tenants." Furthermore, the Decision notes that the elevator "breaks down frequently" and that "the on-site manager is very difficult to reach."

Substantial evidence exists to support the Decision regarding the physical and market conditions relating to the property and its individual units, for which conditions the Vega Adjustment was denied. Tenant declarations were entered into evidence that describe the physical location of the property near Caltrain and a lumberyard, which location impacts the tenants through noise, vibration, and odor/air quality (Evidence Exhibits D and H).<sup>10</sup> The appeal submitted by Appellant-Landlord acknowledges that the physical location of the property near Caltrain and the lumberyard has impacted Appellant-Landlord's requested rents (Appeal P.2, ¶3).

Likewise, the declarations describe the conditions of individual units, alleging under penalty of perjury that their various tenancies have lasted between 4 and 35 years, during which time some units have received replacement appliances and/or fixtures including toilets, but generally have not been remodeled or subject to significant renovations. In one instance a tenant was charged for replacement blinds. Moreover, multiple tenants stated that the elevator is unreliable, that they lack dishwashers, and that connecting with the building manager is difficult. Tenants on upper floors stated that temperature control is a problem. Tenants of unit 233 submitted a second declaration to aver that the unit is a studio, directly contradicting the characterization of the unit as a junior one-bedroom by Appellant-Landlord, which characterization would negate the requested Vega Adjustment valuation for that unit.

Because substantial evidence exists to support the Decision of the Hearing Officer that the Respondent-Tenants successfully contested the revaluation of base year gross income under the Vega Adjustment standards, the Decision to preclude a Vega Adjustment for the Petition is **affirmed**.

**B. Calculation of Adjusted Gross Income in the Base Year**

Worksheet 2, line 1(a)(1) requests that petitioners identify rents lawfully collectible from each rental unit located on the property, calculated at 100% occupancy for 12 months, including increases due to vacancies and annual adjustment increases that could have been implemented. Worksheet 2, line 3 requests that petitioners identify total uncollected rent, to the extent that uncollected rent is beyond the petitioner's good faith efforts to ensure occupancy and payment of debts. Worksheet 2, line 5 calculates adjusted gross income by subtracting reasonable uncollected rent (line 3) from the hypothetical income earned based on 100% occupancy for 12 months (identified in line 1(a)(1)).

Notwithstanding the instructions described above, Appellant-Landlord appears to have submitted total rent actually received in line 1(a)(1) of worksheet 2, which figure excludes all uncollected rent (as confirmed by worksheet 2.1 that was submitted by the Appellant-Landlord). Appellant-Landlord's Petition lists zero uncollected rent in line 3 of worksheet 2 for the base year.

This calculation of adjusted gross income does not comport to the instructions and complicates scrutiny of whether uncollected rents were reasonable pursuant to Regulation Chapter 6, Section D(6) (due to vacancy, non-payment, or other). However, the Decision does not contest the method of calculating adjusted gross income, and the calculation of adjusted gross income is not appealed by Respondent-Tenants.

Setting aside the Vega Adjustment issue, Appellant-Landlord has not demonstrated how the calculation of adjusted gross income in the base year is incorrect. Accordingly, the Decision

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<sup>10</sup> Of the units subject to a potential Vega Adjustment, residents of units 108, 109, 131, 135, 206, 208, 209, 210, 219, 233, 310, and 319 submitted declarations under penalty of perjury.

of the Hearing Officer to accept Appellant-Landlord's submissions on worksheet 2, summarized in the table below to calculate adjusted gross income, is **affirmed**.

**Table 5 Calculation of Adjusted Gross Income**

	<b><u>Base Year</u></b> (\$)
Rent Actually Received	1,636,315
Imputed Rental Value (owner- or employee-occupied units)	18,000
Income from Laundry, Vending, or Similar Facilities	8,664
Uncollected Rents	n/a
	<b>1,662,979</b>

C. Calculation of Adjusted Gross Income in the Petition Year

As stated above, Worksheet 2, line 1(a)(1) requests that petitioners identify rents lawfully collectible from each rental unit located on the property, calculated at 100% occupancy for 12 months, including increases due to vacancy and annual adjustment increases that could have been implemented. Worksheet 2, line 3 requests that petitioners identify total uncollected rent, to the extent that uncollected rent is beyond the petitioner's good faith efforts to ensure occupancy and payment of debts. Worksheet 2, line 5 calculates adjusted gross income by subtracting reasonable uncollected rent (line 3) from the hypothetical income earned based on 100% occupancy for 12 months (identified in line 1(a)(1)).

Respondent-Tenants appeals the calculation of petition year adjusted gross income, arguing that the Decision inaccurately calculates adjusted gross income in the petition year by failing to include unimplemented annual adjustments totaling \$7,126.14. An explanation of the figure is included as a three-page spreadsheet attachment to Evidence Exhibit M, labeled as "Exhibit 3 of Second Supplemental Response" (this evidence attached as Appendix B of this Tentative Appeal Decision for reference purposes only, and does not constitute an opinion regarding the validity or persuasiveness of the information contained therein).

The Decision concludes that adjusted gross income in the petition year is \$1,837,472.20. The Decision does not explain how or why adjusted gross income in the petition year varies from the figures submitted by Appellant-Landlord on worksheet 2 of the Petition. For reference purposes, line 4 of worksheet 2 identifies petition year adjusted gross income as \$1,868,930. However, in light of Appellant-Landlord's prior practice of including vacancies in line 1(a)(1) of worksheet 2 for the base year (as opposed to calculating all lawfully collectible rents), considering that Appellant-Landlord's petition year rent rolls submitted as Evidence Exhibit B indicate that Appellant-Landlord actually collected \$1,837,824.48 as rental income (excluding any imputed rental or other income, *see* DMM Rent Roll Petition Year), and as Appellant-Landlord's worksheet 2 incorrectly adds line 4 (total rent loss ) to line 2 (total gross income) instead of subtracting reasonable rent loss from total lawfully collectible rents, substantial evidence does not support the Decision that petition year adjusted gross income equals \$1,837,472.20.

Because the conclusion that petition year adjusted gross income equals \$1,837,472.20 is not supported by substantial evidence, appeals from Appellant-Landlord and Respondent-

Petitioner are granted and this element of the Decision is **remanded** to the Hearing Officer for the limited purpose of calculating petition year adjusted gross income based on proper reference in the Decision to evidence in the record supporting the conclusion.

D. Exclusion of California Apartment Association Membership Renewal Costs as a Business License Fee

Regulation Chapter 6, Section E(1)(b) states in part that operating expenses shall include "business license fees" to the extent they are incurred in connections with the operation of a property containing one or more Covered Rental Units. Regulation Chapter 6, Section E(2)(g) expressly precludes from operating expenses "fees, other than fees expressly authorized by the Act or by the Regulations." Regulation Chapter 6, Section E(2)(j) expressly precludes from operating expenses contributions to lobbying and advocacy efforts or organization attempting to impact legislative issues.

CSFRA sections 1702(r), 1709(d)(7), and 1709(j)(1) provide for a Rental Housing Fee to pay for the implementation and administration of the CSFRA. City Code section 18.54 provides that in part, "every person owning, operating, leasing, or otherwise in the business of multiple housing, where there are five (5) or more units, shall pay an annual business license fee."

The Decision excludes \$1,080.05 worth of expenses from the business license fee line item, of which Appellant-Landlord appeals the exclusion of \$860.25. Evidence supports the conclusion that the funds were spent as "Membership Renewal" for the California Apartment Association ("CAA") on 12/22/2017.

Membership renewal dues for the California Apartment Association are not business license fees and so are properly excluded from operating expenses as a business license fee. Accordingly, the Decision is **modified** to clarify that \$860.25 in CAA membership renewal costs are not a business license fee, as opposed to any justification based on the exclusion of lobbying expenses.

Because Appellant-Landlord argues that the CAA provides services beyond lobbying efforts, and because other elements of the Decision are proposed for remand, the categorization of the CAA membership renewal costs is **remanded** to the Hearing Officer. The Hearing Officer is instructed to review existing evidence in the record in order to appropriately classify the CAA membership renewal costs in one or more categories of operating expenses. The costs may be apportioned among different categories of operating expenses, including but not limited to: lobbying expenses (which portion would be excluded from the net operating income calculation), management expenses, or any other category that is supported by a preponderance of the evidence in the record.

E. Calculation of Base Year Management Expense

Regulation Chapter 6, Section E(1)(g) states in part: "Management expenses are presumed to be six percent (6%) of Gross Income, unless established otherwise. Management expenses in excess of six percent (6%) of Gross Income are presumed to be unreasonable and shall not be allowed unless it is established that such expenses do not exceed those ordinarily charged by commercial management firms for similar residential rental properties[.]"

The Decision stated that "it appears that Landlord's [management] expenses total well over 6% in both [base and petition] years" and concludes that the evidence "fails to support an exception" to the presumption that reasonable management expenses equal six percent of gross income. The Decision applies the six percent presumption to calculate that base year management expenses equal \$99,778.74 (\$1,662,979 multiplied by 0.06).

Appellant-Landlord's appeal neither identifies nor cites evidence in the record that would support a conclusion that reasonable management expenses exceed six percent of gross income. Accordingly, application of the presumption included in Regulation Chapter 6, Section E(1)(g) in the Decision is **affirmed**.

To the extent Appellant-Landlord's appeal may be construed to challenge the validity of Regulation Chapter 6 Section E(1)(g), any such appeal is denied as improper and the conclusion in the Decision, recalculated in light of the finding in this Tentative Appeal Decision is **affirmed**.

F. Exclusion of Petition Year Management Expenses for Failure to Establish that Expenses Beyond Six Percent of Gross Income are Ordinarily Charged by Commercial Management Firms for Similar Residential Rental Properties

As stated above, Regulation Chapter 6, Section E(1)(g) states in part: "Management expenses are presumed to be six percent (6%) of Gross Income, unless established otherwise. Management expenses in excess of six percent (6%) of Gross Income are presumed to be unreasonable and shall not be allowed unless it is established that such expenses do not exceed those ordinarily charged by commercial management firms for similar residential rental properties[.]"

The Decision stated that "it appears that Landlord's [management] expenses total well over 6% in both [base and petition] years" and concludes that the evidence "fails to support an exception" to the presumption that reasonable management expenses equal six percent of gross income.

Again, Appellant-Landlord's appeal neither identifies nor cites evidence in the record that would support a conclusion that reasonable management expenses exceed six percent of gross income. However, there is not substantial evidence in the record to support the calculation of gross income identified in the Decision. Therefore, there is not substantial evidence in the record to calculate petition year management expenses and this element of the Decision is **remanded** to the Hearing Officer for the limited purpose of calculating petition year management expenses, which shall equal six percent of adjusted gross income, and which shall be based on proper reference in the Decision to evidence in the record supporting the conclusion.

G. Calculation of Costs for Ordinary Repair, Replacement, and Maintenance

Both Appellant-Landlord and Respondent-Tenants appeal the calculation of ordinary repair, replacement, and maintenance costs in the base and petition years. Specifically, Appellant-Landlord appeals the exclusion of salaries from the line item in both petition and base year, while Respondent-Tenants appeal an alleged calculation error but supports the exclusion of salaries. Respondent-Tenants also appeal the purported failure to exclude reimbursable expenses from ordinary repair, replacement, and maintenance costs in the base and petition years.

Notwithstanding the appeals from opposing parties, each component of the appeals are jointly discussed below.

**1. Calculation of Base Year Ordinary Repair, Replacement, and Maintenance Costs**

Petition worksheet 3 lists ordinary repair, replacement, and maintenance costs for the base year totaling \$333,782.62. That sum is broken into thirteen categories in worksheet 3.1A, including line item 12, which is identified as "Salaries" benefitting all units totaling \$180,732.13. The detailed description of line item 12 in worksheet 3.1A lists two entries: check number 8726, dated 1/5/15, for \$24.30; and "Employee Compensation – General Ledger Entries," which is undated, for \$180,707.83.

The Decision concludes that base year ordinary repair, replacement, and maintenance costs equal \$130,625.70, which figure is not supported by evidence in the record. As indicated in Respondent-Tenants appeal, subtracting line item 12 of worksheet 3.1A (\$180,732.13) from line 6 of worksheet 3 (\$333,782.62) equals \$153,050.49. However, without further evidentiary support, and in light of Appellant-Landlord's appeal of the exclusion of salaries from base year ordinary repair, replacement, and maintenance costs, this element of the Decision is **remanded** to the Hearing Officer for the limited purpose as described below.

**2. Calculation of Petition Year Ordinary Repair, Replacement, and Maintenance Costs**

For the petition year, Petition worksheet 3 lists ordinary repair, replacement, and maintenance costs as totaling \$358,811.13. That sum is broken into thirteen categories in worksheet 3.1B, including line item 12, which is identified as "Salaries" benefitting all units totaling \$215,505.92. The detailed description of line item 12 in worksheet 3.1B lists six entries:

**Table 6 Detail Description of "Salaries" Line Item from Worksheet 3.1B**

<b>Description</b>	<b>Date</b>	<b>Amount (\$)</b>
Check 2232	12/30/16	10,000.00
Check 2378	5/31/17	13,589.00
Check 2510	10/27/17	896.37
Check 2513	10/27/17	332.40
Check 2515	10/27/17	18.90
"Employee Compensation – General Ledger Entries"	Undated	190,669.25
	<b>Subtotal</b>	<b>215,505.92</b>

The Decision appears to have excluded \$190,669.25 as "Employee Compensation – General Ledger Entries" from ordinary repair, replacement, and maintenance costs in the petition year to conclude that petition year ordinary repair, replacement, and maintenance costs equaled \$168,141.88.

Respondent-Tenants appeal the Decision, requesting that the entire subtotal of \$215,505.92 be excluded from petition year ordinary repair, replacement, and maintenance.

The Decision does not articulate why the line item checks noted above are included in the calculation of petition year ordinary repair, replacement, and maintenance costs beyond the



statement that salaries appear to be duplicative. Because the calculation of base year ordinary repair, replacement, and maintenance costs are remanded, and in light of the discussion of labor costs and reimbursable expenses below, the Respondent-Tenants appeal is granted and the calculation of petition year ordinary repair, replacement, and maintenance costs is **remanded** to the Hearing Officer for the limited purpose as described below.

**3. Exclusion of Salaries from Base and Petition Year Ordinary Repair, Replacement, and Maintenance Costs**

The Decision states that "salary costs must be properly re-categorized as management expenses in both [base and petition] years and appear to be duplicative [of management expenses]." The Decision further states that Appellant-Landlord failed to meet the burden of proof to distinguish between salaries as a component of ordinary repair, replacement, and maintenance costs versus management expenses.

Notably, costs attributable to employees such as wages and salaries appear as various amounts on separate items in the following worksheets: line item 12 of worksheet 3.1A (Ordinary Repair, Replacement, and Maintenance – Base Year); line items 1 through 7 of worksheet 3.4 (Owner-Performed Labor); and the detail description of line item 8 of worksheet 3.5 (Other Operating Expenses).

Appellant-Landlord has submitted voluminous evidentiary documentation in support of labor expenses, including bi-monthly payroll statements for the base and petition years (Evidence, Exhibit B). However, while the Petition indicates some labor costs are attributable to ordinary repair, replacement, and maintenance (worksheets 3.1A and 3.1B), while other labor costs are owner performed labor (worksheet 3.4) and other operating expenses (worksheet 3.5), it is not readily apparent whether and to what extent labor costs are considered management expenses (worksheet 3.3). Moreover, neither the record nor the Decision explains why labor costs are divided as proposed by Appellant-Petitioner and whether any labor costs are included in management expenses. Neither the record nor the Decision clearly compiles or distinguishes which labor costs are attributable to the Property, as compared to other properties for which services were rendered and payroll distributed.

In the Decision, the Hearing Officer concludes that the salaries listed as a component of ordinary repair, replacement, and maintenance costs appear to be duplicative of other costs. Based on the various references to labor/employee costs within the Petition itself, the disorganized state of evidence regarding labor and employee costs, and the apparent calculation error, the Decision fails to identify substantial evidence in the record to support its conclusion and must be remanded. Moreover, the Decision, the Petition, and the evidence do not readily demonstrate that the Appellant-Landlord has carried its burden to substantiate which salary/labor costs are attributable to: ordinary repair, replacement, and maintenance costs, management expenses, and/or other operating expenses, and which or to what extent salaries and labor costs are incidents of ownership of the property. Because there is not substantial evidence in the record to calculate base year or petition year ordinary repair, replacement, and maintenance costs based on salaries (line items 12 of worksheets 3.1A and 3.1B) this element of the Decision is **remanded** to the Hearing Officer for the limited purpose identifying and categorizing salary and/or labor costs attributable to ordinary repair, replacement, and maintenance costs for the base and petition years (as compared to management expenses, and/or other operating expenses) based on a preponderance of the evidence in the record, in order to re-calculate ordinary repair, replacement, and maintenance costs in the base and petition years.

To that end, both Appellant-Landlord and Respondent-Tenant's appeals regarding base year ordinary repair, replacement, and maintenance costs are granted.

#### **4. Reimbursable Expenses in Base and Petition Year Ordinary Repair, Replacement, and Maintenance Costs**

The Decision does not clearly identify whether any reimbursable costs were excluded from base or petition year ordinary, repair, replacement, and maintenance costs. Respondent-Tenants appeal the calculations alleging that the calculations do not excluded reimbursable expenses. Evidence in the record indicates that some costs may have been reimbursable, but the Decision does not clarify whether the evidence was persuasive or if such costs were excluded from ordinary repair, replacement, and maintenance costs. Because the calculation of both base and petition year ordinary repair, replacement, and maintenance costs is **remanded** to the Hearing Officer as described above, the Respondent-Tenants appeal is granted, and the Hearing Officer shall clarify whether the evidence in the record indicating some expenses may have been reimbursable carried any burden to exclude such expenses from the calculation of either base or petition year ordinary repair, replacement, and maintenance costs.

#### **H. Calculation of Capital Improvement Costs**

##### **1. Base Year Capital Improvements**

The Decision excluded from capital improvements the cost of common area pavers in the base year, finding that Appellant-Landlord "provided no evidence that the common area pavers were a necessary cost rather than an unnecessary overimprovement" in accordance with Regulation Chapter 6, Section F(2)(d). The Decision reduced eligible capital improvement costs in the base year to \$14,699.02. Appellant-Landlord appeals the exclusion.

While substantial evidence may exist in the record to support the Decision, the calculation of base year capital improvements is not supported by substantial evidence in the Decision. For reference, were the pavers to be excluded in their entirety from the capital improvements listed in worksheet 3.3 of the Petition, amortized annual capital expenses in the base year would equal \$13,613.38, as shown in the table below.

**Table 7 Base Year Capital Improvement Costs**

<b><u>Item</u></b>	<b><u>Total Cost</u> (\$)</b>	<b><u>Amort.</u> (Yrs.)</b>	<b><u>Annual Cost</u> (\$)</b>	<b><u>Revised</u> (\$)</b>
Pavers	49,250.00	10	4,925.00	
Roof	114,952.00	10	11,495.20	11,495.20
Elevator	42,363.69	20	2,118.18	2,118.18
			<b>18,538.38</b>	<b>13,613.38</b>

Thus, it appears that only a portion of the pavers may been excluded from base year capital improvements. The apportionment may or may not relate to Appellant-Landlord's appeal. Because substantial evidence does not support the calculation of base year capital improvements as described in the Decision, Appellant-Landlord's appeal is granted and the calculation of base year capital improvements is **remanded** to the Hearing Officer for the limited purpose of defining whether and to what extent the cost of the pavers are excluded from capital

improvements as an overimprovement, and whether and to what extent the cost of the pavers should be included as a necessary capital improvement.

## **2. Petition Year Capital Improvements**

The Decision states that Appellant-Landlord "failed to meet its proof burden with regard to the \$14,000 elevator expense in the Petition Year and said expense is excluded, reducing Petition Year Capital Expense to \$ 9,016.57." Appellant-Landlord contests the characterization of the parking lot resurfacing expense as discussed in the Decision. Read broadly, Appellant-Landlord appeals the calculation of the petition year capital improvements.

While substantial evidence may exist in the record, the calculation of petition year capital improvements is not supported by substantial evidence in the Decision. For reference, capital improvements listed in worksheet 3.3 of the Petition, identify amortized annual expense from the resurfacing to equal \$4,478.19. It is unclear whether the Decision included all or a portion of this expense in conjunction with any carryover of the base year capital improvements. Accordingly, Appellant-Landlord's appeal is granted and the calculation of petition year capital improvements is **remanded** to the Hearing Officer for the limited purpose of clarifying whether and to what extent the parking lot resurfacing is an eligible capital improvement as well as the addition of the re-calculated base year capital improvements that carryover to the petition year capital expenses.

### **I. Calculation Operating Expenses in the Base and Petition Years**

The calculation of operating expenses in the base and petition years is a culmination of component calculations, including calculations of business license fees, management expenses, ordinary repair, replacement, and maintenance costs, and amortized capital improvements.

Respondent-Tenants appeal the calculation of petition year operating expenses and request that petition year operating expenses be reduced "by at least \$12,313.94" based on allegedly unsubstantiated expenses, including a \$1,100 check to P.W. Stephens Environmental that may have been counted twice.

Because various component parts of the calculation of operating expenses in the base and petition years is remanded to the Hearing Officer, the re-calculation of base and petition year operating expenses is necessarily included in that **remand**. Because the record indicates that the check to P.W. Stephens Environmental may or may not have been double counted but the Decision does not clearly identify that expense when calculating operating expenses, Respondent-Tenants appeal is granted and the Hearing Officer shall clarify whether evidence in the record is persuasive that the check was not counted twice when calculating petition year operating expenses.

### **J. Allocation of Upward Adjustments**

The Decision allocates an increase equally across all units, which amount is based on the maintenance of net operating income methodology. Appellant-Landlord appeals the even allocation of rent increases. The Decision cites the general rules found in Regulations Chapter 6, Sections J. The Decision further states, "since Landlord admits that it does not charge expenses to any specific unit, but charges expenses across all of them, the same should apply to any rent increases under the Act" (citing Appellant-Landlord submission on worksheet 6 of the Petition).

Although the Decision and its equal allocation of rent increases is supported by substantial evidence and the Appellant-Landlord's appeal is denied, the allocation of rent increase is necessarily **remanded** to the Hearing Officer in order to allow for the reallocation of any rent increase dependent upon the recalculation of petition year adjusted gross income as well as base year and petition year operating expenses as required by this Tentative Appeal Decision.

## V. **Conclusion**

As detailed above, the RHC grants in part and denies in part Appellant-Landlord's appeal of the Decision. The RHC grants in part and denies in part the Respondent-Tenants' appeal of the Decision, as summarized below.

The Decision of the Hearing Officer that junior one-bedroom units shall be valued as "efficiencies" for purposes of Regulation Chapter 6, Section G(3) (Vega Adjustment) is **affirmed**.

The Decision of the Hearing Officer that the Appellant-Landlord met its burden to rebut the presumption that base year gross income provided for a fair return but that a preponderance of the evidence supports Respondent-Tenants' position that a Vega Adjustment is unnecessary for the landlord to receive a fair rate of return, fails to ensure fairness, and is otherwise contrary to the purposes of the CSFRA is **affirmed**.

The Decision of the Hearing Officer calculating the base year adjusted gross income is **affirmed**.

The Decision of the Hearing Officer calculating petition year adjusted gross income is **remanded** to the Hearing Officer for the limited purpose of calculating petition year adjusted gross income with appropriate reference to evidence in the record that supports such calculation.

The Decision of the Hearing Officer to exclude California Apartment Association membership renewal costs is **modified** to state that such costs are not a business license fee; the expense is **remanded** to the Hearing Officer for the limited purpose of re-categorizing the costs as one or more types of operating expense based on a preponderance of the evidence in the record.

The Decision of the Hearing Officer calculating the base year management expenses is **affirmed**.

The Decision of the Hearing Officer calculating the petition year management expenses is **remanded** to the Hearing Officer for the limited purpose of calculating the presumed reasonable management expenses in accordance with Regulation Chapter 6, Section E(1)(g) and verifying whether petition year management expenses submitted in the Petition are greater than or equal to the presumed reasonable petition year management expenses.

The Decision of the Hearing Officer calculating base year ordinary repair, replacement, and maintenance costs is **remanded** to the Hearing Officer for the limited purposes of: (1) including or excluding all or a portion of salary/labor costs based on a preponderance of evidence in the record; and (2) clarifying whether a preponderance of the evidence in the record supports the exclusion of identified expenses as either reimbursed or reimbursable pursuant to Regulation Chapter 6, Section E(2)(d).

The Decision of the Hearing Officer calculating petition year ordinary repair, replacement, and maintenance costs is **remanded** to the Hearing Officer for the limited purposes of: (1) including or excluding all or a portion of salary/labor costs based on a preponderance of evidence in the record; and (2) clarifying whether a preponderance of the evidence in the record

supports the exclusion of identified expenses as either reimbursed or reimbursable pursuant to Regulation Chapter 6, Section E(2)(d).

The Decision of the Hearing Officer calculating base year capital improvements is **remanded** to the Hearing Officer for the limited purpose of defining whether and to what extent the cost of the pavers are included and excluded from capital improvements with reference to the exclusion of overimprovements in Regulation Chapter 6, Section F(2)(d).

The Decision of the Hearing Officer calculating petition year capital improvements is **remanded** to the Hearing Officer for the limited purpose of clarifying whether and to what extent the parking lot resurfacing is an eligible capital improvement as well as the inclusion of any re-calculated base year capital improvements that carryover to the petition year.

The Decision of the Hearing Officer calculating total base and petition year operating expenses is **remanded** to the Hearing Officer for the limited purposes of: (1) incorporating the calculations and revisions described above; and (2) clarify whether a preponderance of the evidence in the record indicates that the \$1,100 check to P.W. Stephens Environmental may have been counted twice.

The Decision of the Hearing Officer to equally allocate any rent increase allowed under the maintenance of net operating income calculation is **affirmed**, but the calculation of any rent increase is necessarily **remanded** to the Hearing Officer for the limited purpose of incorporating the calculations and revisions described above.

To the extent any appeal challenges the facial validity of any aspect of the CSFRA or its implementing regulations, such appeal is denied.

Accordingly, the Decision is hereby **remanded** to the Hearing Officer for the limited purposes described herein.

**Appendix A**

Vega Adjustment Summary Table

Unit #	Unit Type	Vega Adjustment Requested?	Subject Unit?	Base Year		Ave. Rent Received per Occupied Month	HUD FMR	Potential Vega Adjusted Annual Income	Difference (Potential Vega Adjusted Annual Income less Rent Actually Received)
				Rent Received (Annual)	Months Occupied				
101	Junior	Yes	Yes	15200	12	1266.67	1213		
102	Junior	Yes	Yes	16800	12	1400.00	1213		
103	Junior	Yes	No						
104	Junior	No	No						
105	Junior	Yes	Yes	16800	12	1400.00	1213		
107	Junior	No	No						
108	Junior	Yes	Yes	13700	12	1141.67	1213	14556	856
109	Junior	Yes	Yes	13760	12	1146.67	1213	14556	796
110	2-Bdrm	Yes	Yes	20400	12	1700.00	1809	21708	1308
111	Junior	No	No						
112	Junior	Yes	Yes	13475	10	1347.50	1213		
113	Small	No	No						
114	Junior	No	No						
115	Junior	Yes	Yes	16350	12	1362.50	1213		
116	Junior	Yes	No						
117	Small	No	No						
118	Junior	Yes	No						
119	Small	No	No						
120	Junior	Yes	No						
121	Small	No	Yes						
122	Junior	Yes	No						
123	Large	No	Yes						
124	Eff.	Yes	No						
125	Eff.	Yes	No						
126	Eff.	No	Yes						
127	Junior	Yes	Yes	15600	12	1300.00	1213		
128	Junior	Yes	Yes	15600	12	1300.00	1213		
129	Eff.	No	No						
130	Eff.	No	Yes						
131	Junior	Yes	Yes	14400	12	1200.00	1213	14556	156

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132	Eff.	Yes	Yes	13900	12	1158.33	1213	14556	656
133	Eff.	No	Yes						
134	Eff.	No	No						
135	Eff.	Yes	Yes	13500	12	1125.00	1213	14556	1056
201	Junior	Yes	Yes	15200	12	1266.67	1213		
202	Junior	Yes	No						
203	Junior	No	No						
204	Junior	Yes	No						
205	Junior	Yes	Yes	14700	12	1225.00	1213		
206	Small	Yes	Yes	16300	12	1358.33	1419	17028	728
207	Small	No	No						
208	Junior	Yes	Yes	13900	12	1158.33	1213	14556	656
209	Junior	Yes	Yes	13900	12	1158.33	1213	14556	656
210	2-Bdrm	Yes	Yes	19100	12	1591.67	1809	21708	2608
211	Junior	Yes	Yes	14400	12	1200.00	1213	14556	156
212	Junior	Yes	No						
213	Small	No	Yes						
214	Small	No	Yes						
215	Junior	Yes	Yes	16500	12	1375.00	1213		
216	Junior	No	No						
217	Small	No	No						
218	Junior	No	Yes						
219	Small	Yes	Yes	16635	12	1386.25	1419	17028	393
220	Junior	No	Yes						
221	Small	No	No						
222	Junior	Yes	Yes	14900	12	1241.67	1213		
223	Large	No	Yes						
224	Eff.	Yes	Yes	14040	12	1170.00	1213	14556	516
225	Eff.	No	No						
226	Eff.	Yes	No						
227	Junior	No	No						
228	Junior	Yes	No						
229	Junior	Yes	Yes	15020	12	1251.67	1213		
230	Eff.	No	Yes						
231	Junior	Yes	No						
232	Eff.	No	Yes						
233	Junior	Yes	Yes	14060	12	1171.67	1213	14556	496
234	Eff.	Yes	Yes	14015	12	1167.92	1213	14556	541

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235	Eff.	Yes	No						
301	Junior	Yes	Yes	13800	12	1150.00	1213	14556	756
302	Junior	No	No						
303	Junior	Yes	No						
304	Junior	Yes	No						
305	Junior	Yes	No						
306	Small	Yes	No						
307	Small	No	Yes						
308	Junior	Yes	Yes	15600	12	1300.00	1213		
309	Junior	Yes	Yes	14395	12	1199.58	1213	14556	161
310	2-Bdrm	Yes	Yes	20300	12	1691.67	1809	21708	1408
311	Junior	Yes	No						
312	Junior	Yes	Yes	15555	12	1296.25	1213		
313	Small	No	Yes						
314	Small	No	No						
315	Junior	No	Yes						
316	Junior	No	No						
317	Small	No	No						
318	Junior	Yes	No						
319	Small	Yes	Yes	16650	12	1387.50	1419	17028	378
320	Junior	Yes	No						
321	Small	Yes	No						
322	Junior	No	Yes						
323	Large	No	No						
324	Eff.	No	No						
325	Eff.	Yes	No						
326	Eff.	No	No						
327	Junior	Yes	Yes	14520	12	1210.00	1213	14556	36
328	Junior	Yes	Yes	14775	12	1231.25	1213		
329	Junior	No	Yes						
330	Junior	Yes	No						
331	Junior	Yes	Yes	14850	12	1237.50	1213		
332	Eff.	No	Yes						
333	Junior	Yes	Yes	13725	12	1143.75	1213	14556	831
334	Eff.	Yes	Yes	13725	12	1143.75	1213	14556	831
335	Eff.	Yes	No						
104 Units		63 – Yes 47 – No	56 – Yes 54 – No						15,979



**Appendix B**

Evidence Exhibit M, labeled as "Exhibit 3 of Second Supplemental Response"

Unit	Current Rent Reported in Original Petition	2017 AGA for Unit (3.4% Increase)**	Was 2017 AGA Implemented?	If Yes, When?	Lawfully Collectible Increase Not Implemented in September 2017	Lawfully Collectible Increase Not Implemented in October 2017
101	1300	44.2	No		44.2	44.2
102	1400	47.6	No		47.6	47.6
103	1800	61.2	No		61.2	61.2
104	1706	Not Eligible During Petition Year (Move in 12/26/16)				
105	1448	\$48**	Yes	11/1/2017	48	48
107	0	Manager				
108	1150	39.1	No		39.1	39.1
109	1190	40.46	No		40.46	40.46
110	1600	54.4	No		54.4	54.4
111	1706	56**	Yes	9/1/2017		
112	1551	51**	Yes	11/1/2017	51	51
113	1716	56**	Yes	11/1/2017	56	56
114	1706	56**	Yes	9/1/2017		
115	1400	47.6	No		47.6	47.6
116	1448	48**	Yes	11/1/2017	48	48
117	1525	51.85	No		51.85	51.85
118	1706	56**	Yes	9/1/2017		
119	1530	52.02	No		52.02	52.02
120	1965	65**	Yes	12/1/2017	65	65
121	1500	51	No		51	51
122	1757	57**	Yes	11/1/2017	57	57
123	1700	57.8	No		57.8	57.8
124	1175	50**	Yes	10/1/2017	50	
125	1602	50**	Yes	9/1/2017		
126	1375	46.75	No		46.75	46.75
127	1300	44.2	No		44.2	44.2
128	1300	44.2	No		44.2	44.2
129	1900	65**	Yes	9/1/2017		
130	1422	47**	Yes	11/1/2017	47	47
131	1200	40.8	No		40.8	40.8
132	1175	39.95	No		39.95	39.95
133	1344	24**	Yes	11/1/2017	24	24
134	1499	49**	Yes	11/1/2017	49	49
135	1241	41**	Yes	11/1/2017	41	41
201	1479	49**	Yes	11/1/2017	49	49
202	1654	54**	Yes	9/1/2017		
203	1706	56**	Yes	9/1/2017		
<b>EXHIBIT 3 OF SECOND SUPPLEMENTAL RESPONSE</b>						
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204	1758	58**	Yes	11/1/2017	58	58
205	1250	42.5	No		42.5	42.5
206	1344	44**	Yes	11/1/2017	44	44
207	2200	Not Eligible During Petition Year (Move in 2/1/17)				
208	1200	40.8	No		40.8	40.8
209	1200	40.8	No		40.8	40.8
210	1600	54.4	No		54.4	54.4
211	1303	44**	Yes	11/1/2017	44	44
212	1731	56**	Yes	9/1/2017		
213	1629	54**	Yes	11/1/2017	54	54
214	1577	52**	Yes	11/1/2017	52	52
215	1425	48.45	No		48.45	48.45
216	2000	Not Eligible During Petition Year (Move in 6/28/17)				
217	0	Reported Vacancy				
218	1425	48.45	No		48.45	48.45
219	1430	48.62	No		48.62	48.62
220	1450	49.3	No		49.3	49.3
221	0	Reported Vacancy				
222	1250	42.5	No		42.5	42.5
223	1700	57.8	No		57.8	57.8
224	1220	41.48	No		41.48	41.48
225	0	Reported Vacancy				
226	1602	52**	Yes	9/1/2017		
227	1757	57**	Yes	11/1/2017	57	57
228	1654	54**	Yes	9/1/2017		
229	1303	43**	Yes	11/1/2017	43	43
230	1375	45**	Yes	11/1/2017	45	45
231	1706	56**	Yes	9/1/2017		
232	1350	45.9	No		45.9	45.9
233	1300	44.2	No		44.2	44.2
234	1319	44**	Yes	11/1/2017	44	44
235	1225	41.65	No		41.65	41.65
301	1225	41.65	No		41.65	41.65
302	1900	Not Eligible During Petition Year (Move in 2/11/17)				
303	2000	Not Eligible During Petition Year (Move in 8/26/17)				
304	1430	48.62	No		48.62	48.62
305	1758	Not Eligible During Petition Year (Move in 10/8/16)				
306	1370	45**	Yes	11/1/2017	45	45
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307	1577	52**	Yes	11/1/2017	52	52
308	1325	45.05	No		45.05	45.05
309	1350	45.9	No		45.9	45.9
310	1700	57.8	No		57.8	57.8
311	400	Not Eligible During Petition Year (Move in 10/24/17)				
312	1375	46.75	No		46.75	46.75
313	1700	57.8	No		57.8	57.8
314	1700	57.8	No		57.8	57.8
315	1473	48**	Yes	12/1/2017	48	48
316	2000	Not Eligible During Petition Year (Move in 11/8/17)				
317	1680	55**	Yes	11/1/2017	55	55
318	1380	46.92	No		46.92	46.92
319	1473	48**	Yes	11/1/2017	48	48
320	1654	54**	Yes	11/1/2017	54	54
321	2250	Not Eligible During Petition Year (Move in 2/18/17)				
322	1551	51**	Yes	11/1/2017	51	51
323	2171	71**	Yes	9/1/2017		
324	1396	47.464	No		47.46	47.46
325	1551	51**	Yes	9/1/2017		
326	1900	Not Eligible During Petition Year (Move in 8/23/17)				
327	1210	41.14	No		41.14	41.14
328	1325	45.05	No		45.05	45.05
329	1473	48**	Yes	11/1/2017	48	48
330	1900	Not Eligible During Petition Year (Move in 4/3/17)				
331	1250	42.5	No		42.5	42.5
332	1325	45.05	No		45.05	45.05
333	1150	39.1	No		39.1	39.1
334	1250	42.5	No		42.5	42.5
335	1602	52**	Yes	9/1/2017		
Totals					\$3,588.07	\$3,538.07
Total Lawfully Collectible Rents Not Reported in Petition Year Income					\$7,126.14	
**These increases appear to be captured in the current rents reported. The increased numbers were reported in Worksheet 1A of the Original Petition.						
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