HR&A ADVISORS,INC.
DRAFT ISSUE PAPERS

HR&A ADVISORS, INC.
RENT STABILIZATION ANALYSIS
DRAFT DATA BRIEF

PREPARED FOR THE CITY OF BEVERLY HILLS

RENT STABILIZATION ANALYSIS

DRAFT DATA BRIEF

JULY 26, 2018

HR&A Analyze. Advise. Act.

BEVERLY HILLS

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INTRODUCTION

BACKGROUND

The City of Beverly Hills (the "City" or "Beverly Hills") adopted Chapter 5 of Title 4 of the City's Municipal Code ("Chapter 5") in 1978, implementing a Rent Stabilization Ordinance ("RSO") that caps the amount by which housing providers can increase rents annually for tenants with original rent contracts of $600 or less per month and who live in buildings constructed prior to September 21, 1978. For tenancies that are covered by Chapter 5, housing providers may increase rents by the lesser of eight percent or the annual percent change in the Consumer Price Index ("CPI") for the Los Angeles area.

In 1986, the City adopted Chapter 6 of Title 4 of the City's Municipal Code ("Chapter 6"), establishing a second RSO provision that applies to tenants with original rent contracts that exceed $600 per month and live in residential buildings with two or more units built prior to February 1, 1995. Under the original provisions of Chapter 6, housing providers were permitted to increase rents by up to 10 percent annually.

In 1995, the State of California adopted the Costa Hawkins Rental Housing Act ("Costa Hawkins"), precluding the ability for California cities to impose rent control on single-family residential buildings and condominiums, and any building built after February 1995. Costa Hawkins also enables housing providers to raise rents to market rate levels once a tenant voluntarily moves out of a unit, although rent increases may be capped annually thereafter until the next tenant moves out, a regulatory mechanism known as "vacancy decontrol." However, Costa Hawkins does not prevent cities from imposing requirements for the payment of relocation fees or "just cause" eviction requirements.

In light of Costa Hawkins, the City's RSO only practically applies to rental residential buildings with two or more units built prior to March 1995. However, at the time of this writing, Proposition 10 on the November 2018 statewide ballot seeks to repeal Costa Hawkins.[1] Passage would enable cities throughout California with rent regulations to reconsider the limitations imposed by Costa Hawkins.

The Beverly Hills City Council modified certain provisions of the RSO in 2017, in response to concerns raised by City residents that the existing regulations were ineffective and that rapid rent increases were leading to resident displacement. The changes made pursuant to ordinances 17-0-2729 and 17-0-2745 (the "RSO Amendments") include:

- Limiting rent increases to the greater of three percent per year or the annual percent change in the CPI for the Los Angeles area under Chapter 6, a shift from the previously allowable 10 percent per year;
- Imposing new relocation fees for "no just-cause" evictions (any eviction besides those due to tenant failure to pay rent, maintenance of a nuisance, illegal uses, failure to execute a lease, refusal to provide unit access to housing provider, or presence of unapproved subtenants) for Chapter 6 tenants;
- Setting uniform relocation fees for Chapter 5 and Chapter 6;

[1] https://www.oag.ca.gov/system/files/initiatives/pdfs/17-0041%20%28Affordable%20Housing%29_0.pdf

- Requiring multifamily rental housing providers to register all rental units with a City database (the "RSO Registry") that may be updated annually and monitored;
- Requiring that housing providers comply with RSO Registry requirements before being permitted to increase rents;
- Exempting Chapter 5 units that are not a tenant's primary residence from the RSO;
- Defining a number of key terms for both Chapter 5 and Chapter 6; and
- Creating a rent increase application process for housing providers under Chapter 6;

PURPOSE OF THE DATA BRIEF

Following the 2017 RSO changes, the City retained HR&A Advisors, Inc. ("HR&A") to provide independent analysis of certain policy issues that emerged during professionally-facilitated dialogue sessions between housing providers and tenants, as well as public testimony before the City Council, following adoption of the RSO Amendments. These issues include:

- The formula for the maximum allowable annual rent increase;
- Amounts and beneficiaries of relocation fees that housing providers must pay in cases of no-cause evictions;
- Whether to exempt two- to four-unit buildings from RSO regulation;
- The procedures and remedies for "no just-cause" evictions not already addressed by the Beverly Hills Municipal Code;
- Whether to allow housing providers to "bank" unused portions of the annual general adjustment for use in future years;
- The process available to housing providers to seek rent increases; and
- Implications of the Ellis Act.

As part of its work to help the City consider these issues, HR&A prepared this Data Brief to assemble and analyze a variety of household, multifamily housing stock, and apartment building financial data as a factual foundation for addressing the issues listed above, and subsequent public discussion about them.

DATA BRIEF STRUCTURE AND SOURCES

This Data Brief provides a profile of the following:

1. The City's housing stock subject to the RSO ("RSO Buildings" or "RSO Units");
2. Renters and households residing in Beverly Hills and in units subject to the RSO ("RSO Tenants"); and
3. The financial characteristics of apartment buildings subject to the RSO.

HR&A used a variety of data sources to prepare these three subject area profiles. Specifically, HR&A relied on data available from the City's RSO Registry; the U.S. Census Bureau, including the decennial census and the annual American Community Survey ("ACS"); CoStar Group, Inc. ("CoStar") real estate data; and apartment building financial data assembled by the Institute of Real Estate Management ("IREM") and the National Apartment Association ("NAA").

A brief overview of each source used in this Data Brief follows.

RSO REGISTRY DATA

As required by the 2017 RSO amendments, the City created a mandatory registration system for multifamily residential

buildings within Beverly Hills subject to the RSO (the "RSO Registry"). The City provided HR&A with data from the RSO Registry that offers an array of building stock, tenant, and building operations characteristics for the current year, but without linking those data to specific buildings or owners. The RSO Registry data reflects 2017 information and was provided to HR&A on March 21, 2018.

The RSO Registry file provided to HR&A has data for 1,096 buildings containing 7,698 units. However, the file includes three properties containing a total of 17 units that are recorded as having been built after 1995. Properties built after 1995 cannot legally be subject to rent restrictions pursuant to Costa Hawkins, and HR&A therefore excluded these three properties and their 17 units from the analysis contained in this report. The three properties and 17 units that were excluded represent less than one percent of all RSO properties and units, and their exclusion from the analysis is therefore assumed have a *de minimis* impact on the reported general characteristics of buildings subject to the RSO. HR&A's analysis therefore reflects data for 1,093 properties containing 7,681 units.

For ease of data presentation, HR&A grouped 2.5-bedroom unit data (four total units) with three-bedroom units, and grouped five-bedroom unit data (one total unit) with four-bedroom units into a four or more bedrooms category.

U.S. CENSUS BUREAU DATA

The U.S. Census Bureau is a federal agency that regularly collects and records various detailed data about the nation's people, housing and economy. U.S. Census Bureau data do not provide the level of customization necessary to analyze RSO Buildings and RSO Tenants exclusively, but reasonable inferences about RSO Buildings and Tenants can be drawn from the more generalized categories within U.S. Census Bureau data for Beverly Hills.

For selected housing stock information, HR&A separated out applicable RSO building data by evaluating census data on tenure by units in structure by year built corresponding to rental multifamily buildings constructed prior to 2000 in Beverly Hills. Based on a review of CoStar (see below) data, HR&A determined that no new multifamily buildings were built in the City between 1995 and 2000, indicating that it can be assumed that multifamily rental units built prior to 2000 are equivalent to RSO Units. Using this method, HR&A determined that the U.S. Census Bureau's 2012-2016 5-Year ACS data (the most recent year for which data are available) for Beverly Hills counted 7,580 RSO Units.

Furthermore, the ACS shows a total of 8,563 renter households in all building types in Beverly Hills. Because the RSO Registry documents that there are 7,580 RSO Units, and this number accounts for 88 percent of all renter households in the City (and is equal to 99 percent of the adjusted RSO Registry inventory), HR&A assumed that census data available for all rental households in Beverly Hills can reasonably be relied on to describe the general characteristics of RSO tenants and their households.

HR&A drew comparisons between Beverly Hills and other nearby cities including Los Angeles, Santa Monica, and West Hollywood, as well as Los Angeles County (the "County") as a whole, for select data points, but it should be noted that the data for these comparative areas includes all renter households and is not limited to those subject to rent stabilization within their respective jurisdictions (i.e., there are greater differences between the number of rent-stabilized units and all rental units in these other areas than is the case for Beverly Hills).

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT DATA

The U.S. Department of Housing and Urban Development ("HUD") is a federal agency that, among its many responsibilities, records and prepares data related housing. In particular, HR&A assessed HUD's Comprehensive Housing Affordability Strategy ("CHAS") data, which documents jurisdiction-specific housing problems and housing needs based on custom tabulations of ACS data received from the U.S. Census Bureau. HR&A used CHAS data to assemble information on the physical condition of the City's rental building stock relative to comparative surrounding areas. As with the HR&A's application of the ACS, Beverly Hills data is based on all renters and multifamily buildings in the City, the majority of which are subject to the RSO; data for comparative areas also include all renter households.

COSTAR GROUP, INC. DATA

CoStar is a well-respected and regularly cited third-party real estate data source. CoStar generates and maintains its data by researching individual property records and conducting interviews with property owners and real estate brokers. CoStar's multifamily rental data is detailed for buildings with more than four units, although data for buildings with four or fewer units is more limited. Here again, CoStar data for comparative areas includes all rental housing units and not just those that are rent stabilized in other cities and the County.

INSTITUTE OF REAL ESTATE MANAGEMENT DATA

IREM is a professional real estate management organization that produces research and analysis on numerous real estate industry issues, including apartment income and expense trends. IREM does not provide data for individual properties or customized criteria. Although operating expense data are available for metro areas rather than individual cities, HR&A utilized IREM apartment building operations data for the Los Angeles Metropolitan Area as a general benchmark for trends in components of Net Operating Income ("NOI"). IREM provides NOI data for apartment properties that are low-rise (three stories or less) with 12 to 24 units, low-rise with more than 24 units, and high-rise (four or more stories with an elevator).

NATIONAL APARTMENT ASSOCIATION DATA

NAA is a professional apartment industry trade organization that, like IREM, assembles data, conducts research and prepares annual surveys of apartment income and operating expenses. NAA also provides data only for metro areas rather than individual cities. HR&A evaluated NAA data for the Los Angeles Metropolitan Area for 2017, again to benchmark general NOI characteristics of apartment buildings. NAA distinguishes apartment properties as garden, mid-rise and high-rise.

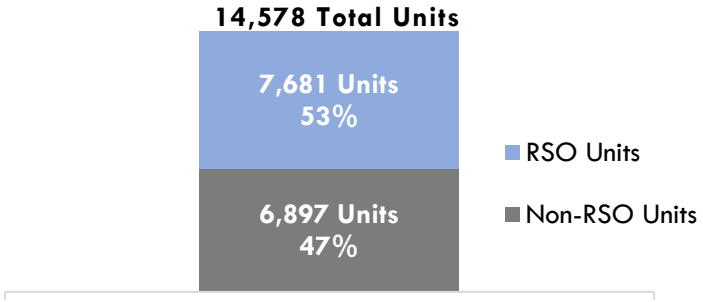
RSO BUILDING STOCK CHARACTERISTICS

According to the RSO Registry, after removing the few properties recorded as having been built after 1995, there are 7,681 RSO Units in 1,093 RSO Buildings in the City. As shown in Figure 1, RSO Units recorded in the RSO Registry make up over half of the City's approximately 14,578 total housing units reported by the ACS. Moreover, RSO Units make up 88 percent of the nearly 8,563 rental housing units in the City reported by the ACS, which includes single-family rental units.

As shown in Figure 2, nearly all of the City's RSO Units were constructed prior to 1980. More than one-third of RSO Units were built before 1940, and more than half were built between 1940 and 1979.

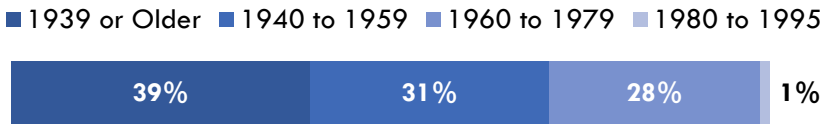
Most buildings subject to the RSO have less than 10 units, as shown in Figure 3. Slightly more than 40 percent of RSO Buildings are duplexes, triplexes, and quadplexes, and 40 percent have between five and nine units. Less than 20 percent of RSO Buildings have 10 or more units. However, as shown in Figure 4, less than 20 percent of RSO Units are contained in duplexes, triplexes, and quadplexes, and most units are contained within buildings that have five or more units.

Figure 1: RSO Share of Total Beverly Hills Housing Units, 2017



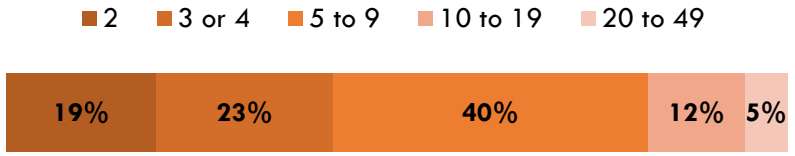
Source: RSO Registry; 2012-2016 ACS
Note: "Non-RSO Units" include all multifamily units that are not subject to the RSO (i.e. condominiums and apartments built after February 1995) and single-family units.

Figure 2: Beverly Hills RSO Units by Year Built, 2017



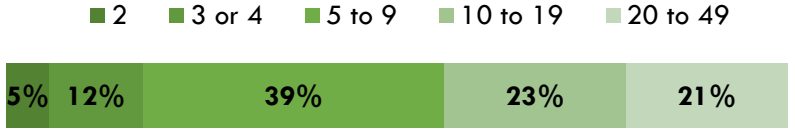
Source: RSO Registry (obtained March 21, 2018)

Figure 3: Beverly Hills RSO Buildings by Number of Units in Structure, 2017



Source: RSO Registry

Figure 4: Beverly Hills RSO Units by Number of Units in Structure, 2017

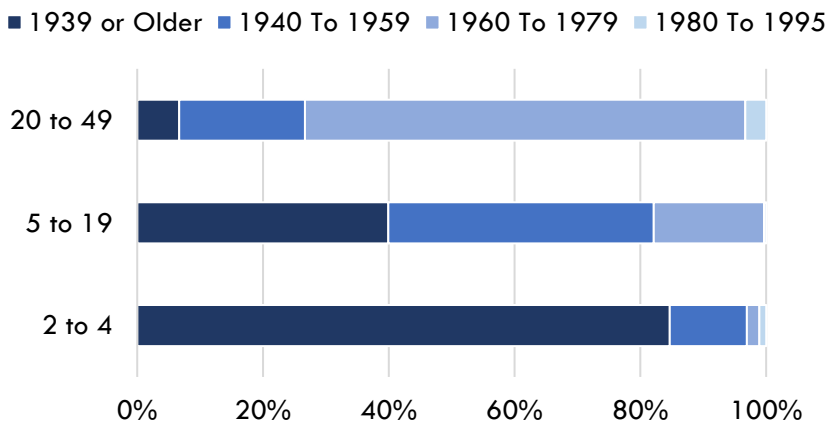


Source: RSO Registry (obtained March 21, 2018)

As shown in Figure 5, smaller RSO Buildings are generally older than larger RSO Buildings. Approximately 97 percent of buildings with two to four units were built prior to 1960, and nearly three quarters of buildings with 20 or more units were built between 1960 and 1995.

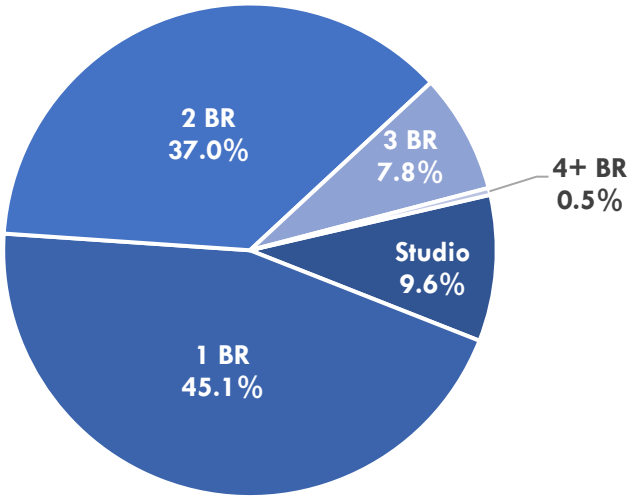
As shown in Figure 6, one- and two-bedroom units make up the majority of RSO Units, followed by a smaller share of studios and three-bedroom units, and very few units with four or more bedrooms. Smaller RSO Buildings generally have units with more bedrooms than larger buildings, as shown in Figure 7. Three-bedroom units make up more than three quarters of units within duplexes, while they account for only four percent of units within buildings of five or more units. Conversely, studio and one-bedroom units make up little more than one percent of units within duplexes, but they compose nearly two-thirds of units within building of five or more units.

Figure 5: Beverly Hills RSO Buildings by Number of Units in Structure by Year Built, 2017



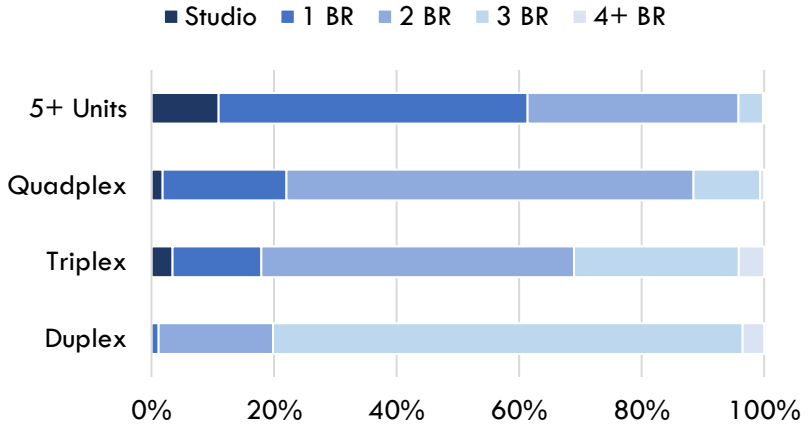
Source: RSO Registry (obtained March 21, 2018)

Figure 6: Beverly Hills RSO Unit Type Distribution, 2017



Source: RSO Registry (obtained March 21, 2018)

Figure 7: Beverly Hills RSO Unit Type Distribution by Number of Units in Structure, 2017

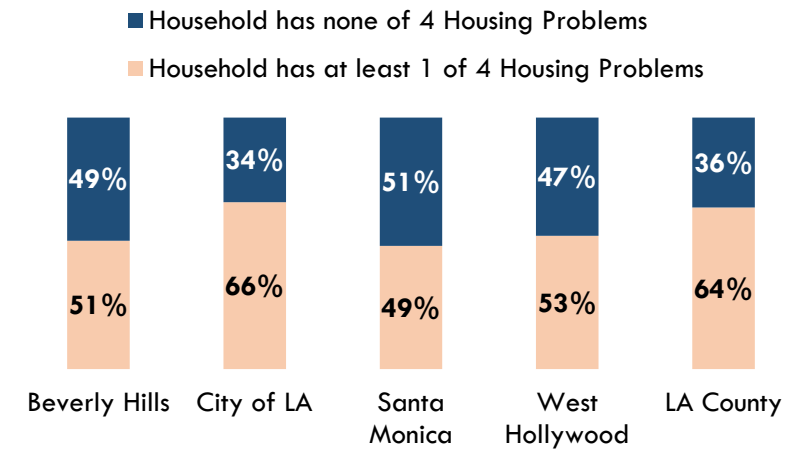


Source: RSO Registry (obtained March 21, 2018)

HUD identifies four classifications of housing problems in its CHAS data: 1) housing unit lacks complete kitchen facilities; 2) housing unit lacks complete plumbing facilities; 3) household is overcrowded; and 4) household is "rent burdened." HUD defines rent burden, or "cost burden," as households that pay more than 30 percent of household income on housing costs, and defines households that pay more than 50 percent of household income on housing costs as "severely rent burdened" or "severely cost burdened."[2] A household is said to have a housing "problem" if it has any one or more of these four problems. These data serve as an indicator of the general physical conditions of the rental housing stock, as well as the economic conditions of the tenants who live in it. The issues of overcrowding and rent burden are discussed in greater detail in the next section.

As shown in Figure 8, over half of Beverly Hills renter households have at least one of the four housing problems, according to the CHAS data. This is a low percentage compared with nearby cities and the County; only Santa Monica has a lower share of households with at least one housing problem and a correspondingly higher share of renter households without any of these housing problems.

Figure 8: Renter Household Physical and Economic Conditions, 2014



Source: HUD CHAS (based on 2010-2014 ACS data)

[2] https://www.huduser.gov/portal/datasets/cp/CHAS/bg_chas.html

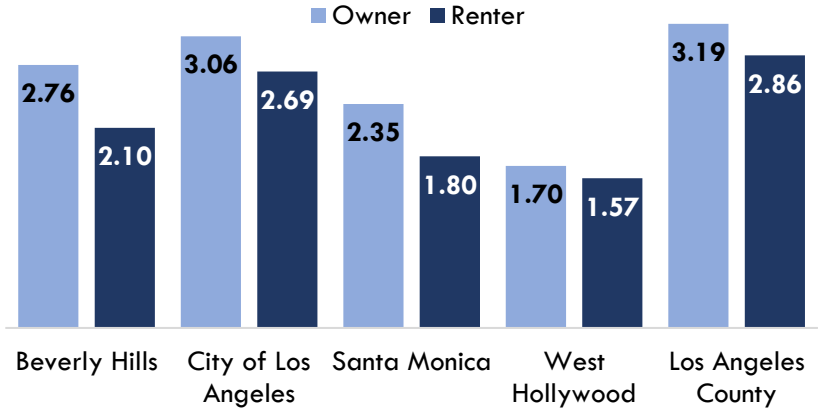
BEVERLY HILLS RENTER AND RSO TENANT HOUSEHOLD CHARACTERISTICS

HOUSEHOLD SIZE & COMPOSITION

Nearly 60 percent of all households, including apartments, condominiums, and single-family homes, in the City are renter-occupied. Renter households are smaller on average than owner-occupied households in Beverly Hills, which is consistent with the characteristics of nearby cities and the County as a whole, as shown in Figure 9. Among these comparative geographies, Beverly Hills renter households are in the middle of the household size (i.e., the number of residents per dwelling unit) range. As shown in Figure 10, a small share of Beverly Hills renter households is overcrowded[3]: two percent of Beverly Hills renter households are overcrowded (i.e. have 1.01 to 1.50 occupants per room), and one percent are severely overcrowded (i.e. have more than 1.50 occupants per room).

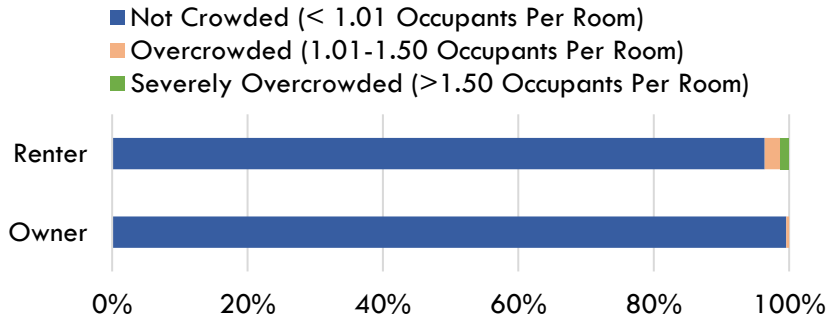
The majority of Beverly Hills renters are generally considered "working age," as over three quarters are younger than 65 years old, as shown in Figure 11. Over half of renter households are between 35 and 64 years old. As shown in Figure 12, approximately one quarter of both Beverly Hills homeowners and renters have children under the age of 18, which is lower than in the City and County of Los Angeles, but much higher than renter households in West Hollywood and Santa Monica, according to the American Community Survey 5-Year Estimates for 2012-2016.

Figure 9: Average Household Size (Residents per Dwelling Unit) by Tenure, 2016



Source: 2012-2016 ACS

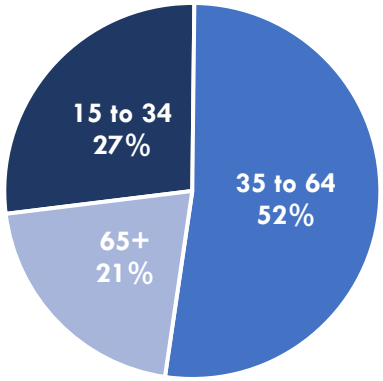
Figure 10: Beverly Hills Average Occupants per Room by Tenure, 2016



Source: 2012-2016 ACS

[3] As defined by the US Department of Housing and Urban Development: https://www.huduser.gov/portal/datasets/cp/CHAS/bg_chas.html

Figure 11: Age of Householder in All Beverly Hills Rental Households, 2016

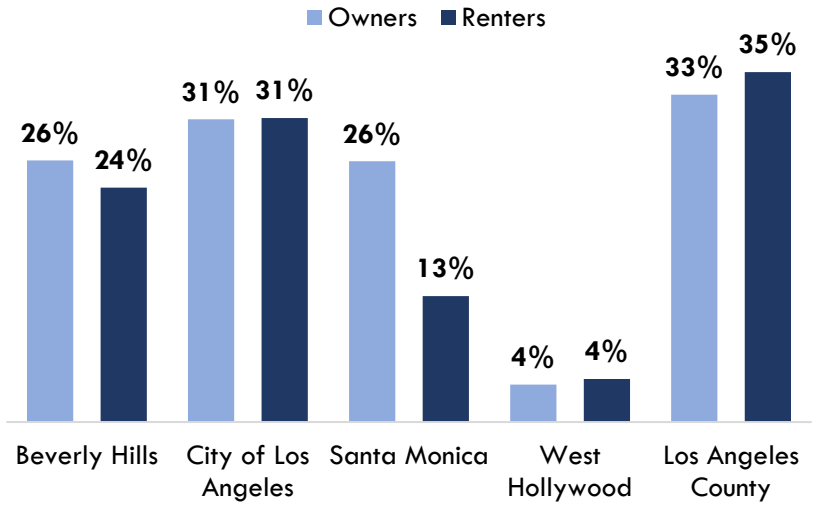


Source: 2012-2016 ACS

HOUSEHOLD INCOME

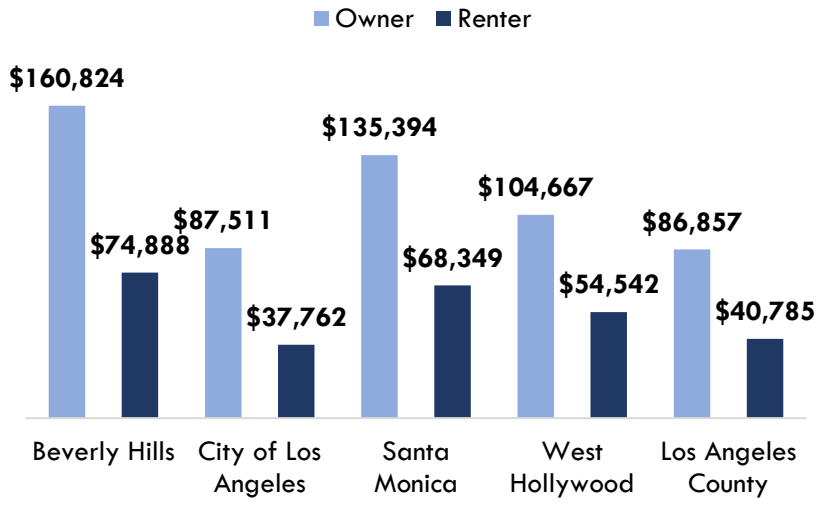
Also in line with nearby cities and the County, the median household income for City homeowners exceeds that of renter households, as shown in Figure 13. However, renter households in Beverly Hills have higher median (i.e., exact midpoint of the range) incomes than in nearby cities and the County. While median household income for homeowners in Beverly Hills is approximately $160,000 per year, and more than double that of renter households (nearly $75,000 per year), renter household incomes have risen somewhat between 2000 and 2016, while homeowner median incomes have declined (adjusted for inflation), as shown in Figure 14.

Figure 12: All Households with Children Under 18 Years Old by Tenure, 2016



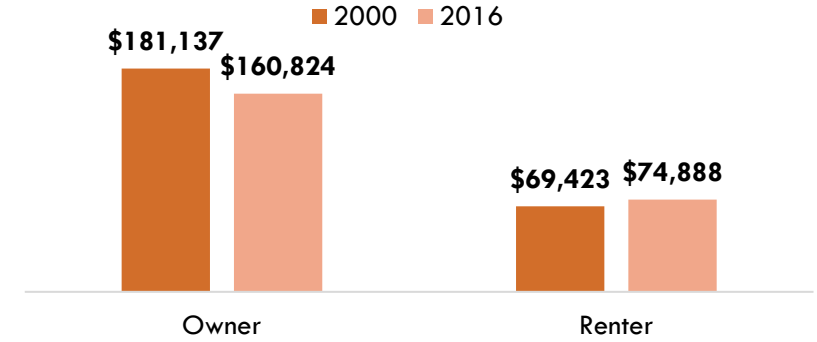
Source: 2012-2016 ACS

Figure 13: Median Household Income for All Household Types by Tenure (in 2016 $)



Source: 2012-2016 ACS

Figure 14: Beverly Hills Median Household Income by Tenure by Year for All Household Types (in 2016 $)

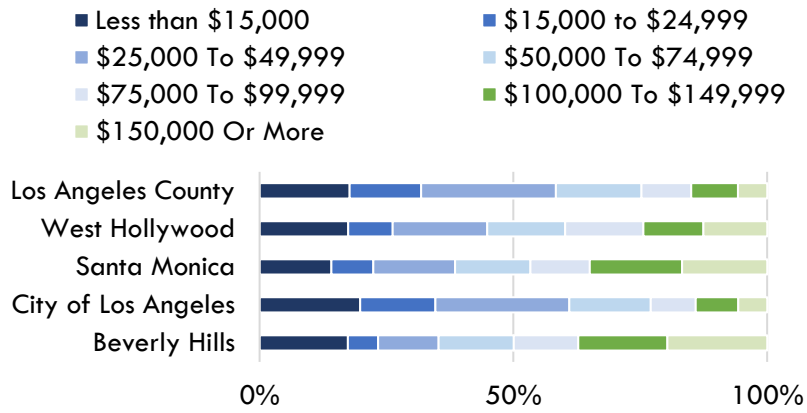


Source: 2012-2016 ACS

Among comparative areas, Beverly Hills has the highest share of renter households with median incomes of $100,000 or more per year, and the lowest share of renter households with median incomes of less than $50,000 per year, as shown in Figure 15. Half of the city's renters have median household incomes of at least $75,000 per year.

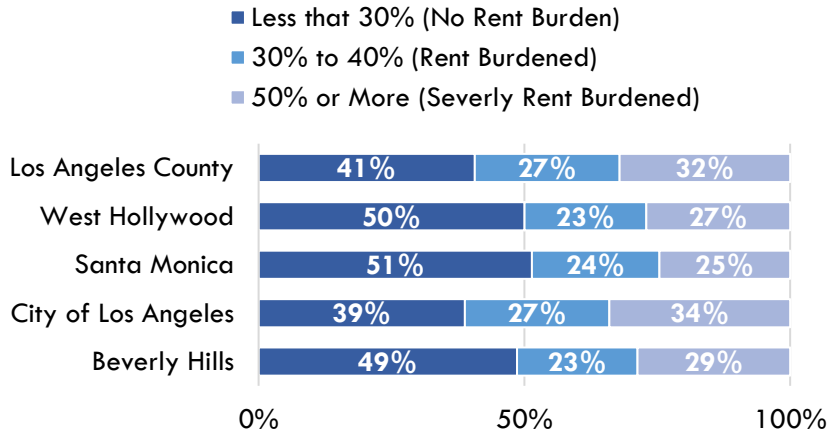
Although renter household incomes in Beverly Hills are generally higher than in nearby cities and the County, over half of the City's renter households are rent burdened, as illustrated in Figure 16. Moreover, nearly 30 percent of the City's renter households (a higher share than in both Santa Monica and West Hollywood), pay more than half of their income on housing costs and are considered severely rent burdened.

Figure 15: Distribution of Renter Median Household Income for All Household Types (in 2016 $)



Source: 2012-2016 ACS

Figure 16: Rent Share of Household Income for All Households Types, 2016

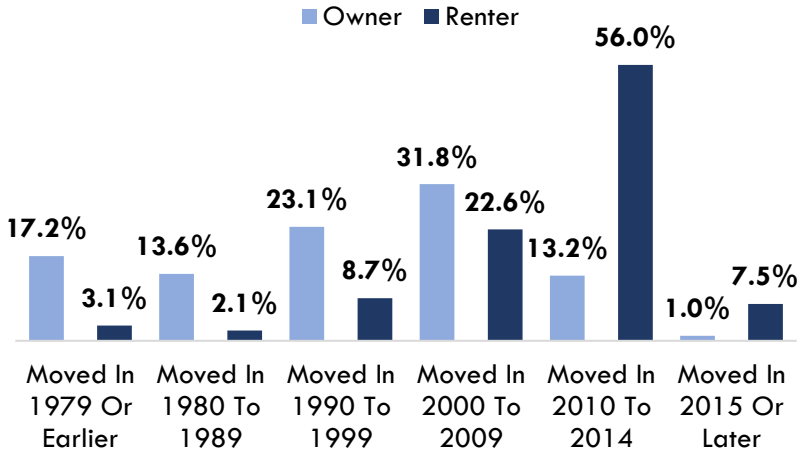


Source: 2012-2016 ACS

HOUSEHOLD TURNOVER

The frequency with which renters move out of units, or the "turnover" rate, is important in the context of the RSO because housing providers can reset rents to current market rates for new tenants when prior tenants move out voluntarily. As shown in Figure 17, Beverly Hills homeowners have largely lived in their units longer than renters. More than half of owners moved into their units prior to 2000, compared with only 14 percent of renters. Nearly two-thirds of the City's renter households moved into their units later than 2009, compared with 14 percent of owners. Among renters of multifamily units in the City, renters in smaller buildings have generally moved into their units more recently than those in larger buildings, as shown in Figure 18. However, the majority of renter households moved into their units after 1999, regardless of building size.

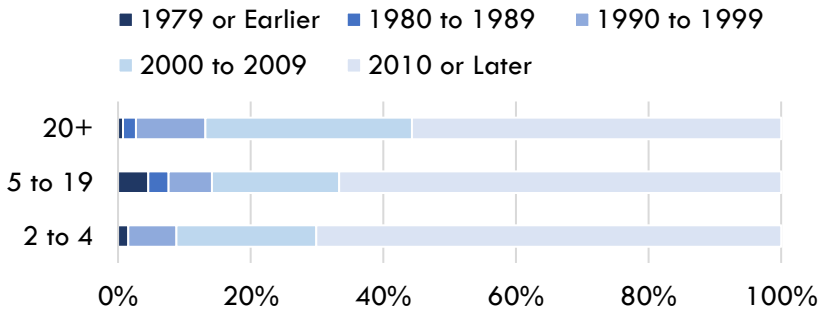
Figure 17: Year Beverly Hills Householder Moved into Unit by Tenure, 2016



Source: 2012-2016 ACS

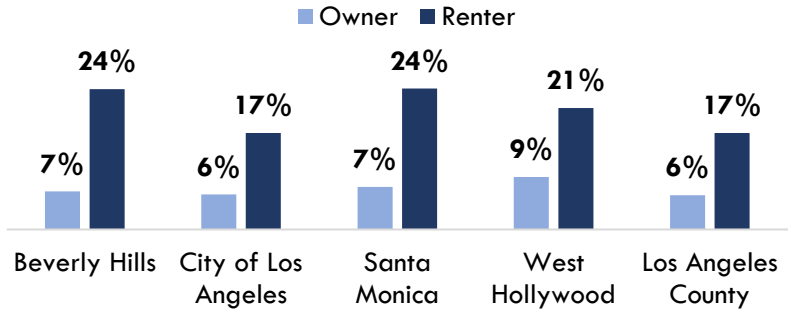
The tendency for homeowners to stay in their homes longer than renters is also reflected in resident turnover rates, or the share of the households that move in a given year. As shown in Figure 19, nearly a quarter of renter households in Beverly Hills move out of their units in a given year, as compared with seven percent of homeowners. Also illustrated in Figure 19, Beverly Hills' renter turnover rate is the highest among most comparative areas, and matches the rate in Santa Monica.

Figure 18: Year Beverly Hills Renter Householder Moved into Unit by Number of Units in Structure, 2016



Source: 2012-2016 ACS

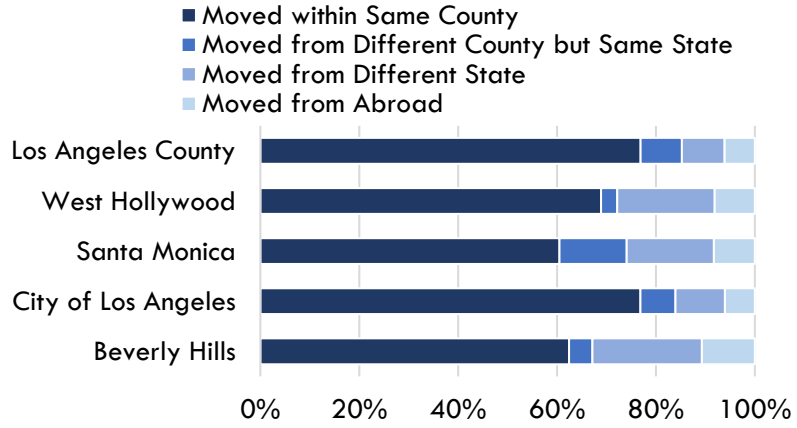
Figure 19: 2016 Household Turnover Rate by Tenure



Source: 2012-2016 ACS

As shown in Figure 20, among renter households that moved to Beverly Hills, nearly two-thirds moved from within Los Angeles County, and a comparatively high share moved from different states (22%) and internationally (11%). In fact, Beverly Hills had the highest share of both out-of-state and international newcomers among comparative areas

Figure 20: Location from Which Renters Moved, 2016



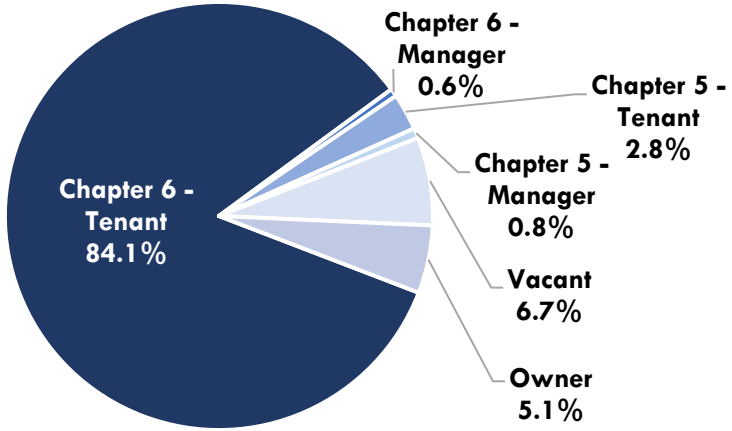
Source: 2012-2016 ACS

RSO TENANT CHARACTERISTICS

As shown in Figure 21, the majority of RSO Units are occupied by Chapter 6 tenants, and only three percent are occupied by Chapter 5 tenants. Seven percent of units in RSO Buildings are vacant, and six percent are occupied by building owners and managers.

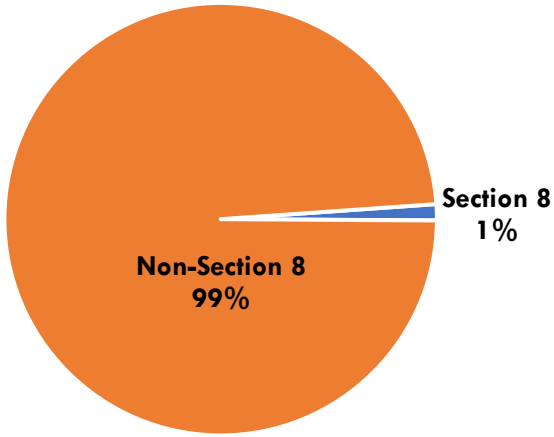
As shown in Figure 22, only one percent of RSO Tenants use Section 8 vouchers, a government housing subsidy. Almost all RSO Tenants that use Section 8 vouchers are Chapter 6 tenants, with the exception of five Chapter 5 tenants.

Figure 21: Beverly Hills RSO Units by Tenant Type, 2017



Source: RSO Registry (obtained March 21, 2018)

Figure 22: Beverly Hills RSO Tenants by Section 8 Status, 2017



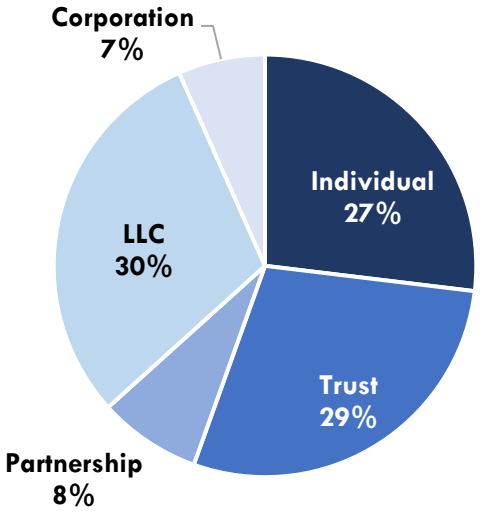
Source: RSO Registry (obtained March 21, 2018)

CHARACTERISTICS OF RSO BUILDING OPERATIONS

OWNERSHIP

RSO Buildings in the City are owned by a mix of professional corporate real estate companies, and individuals with personal investments. As shown in Figure 23, a little more than one quarter of RSO Buildings are owned by individuals; seven percent are owned by corporations; and approximately two-thirds are owned by trusts, partnerships, and Limited Liability Companies ("LLCs"), which may be individuals or subsidiaries of larger companies, but not discernable from the available data.

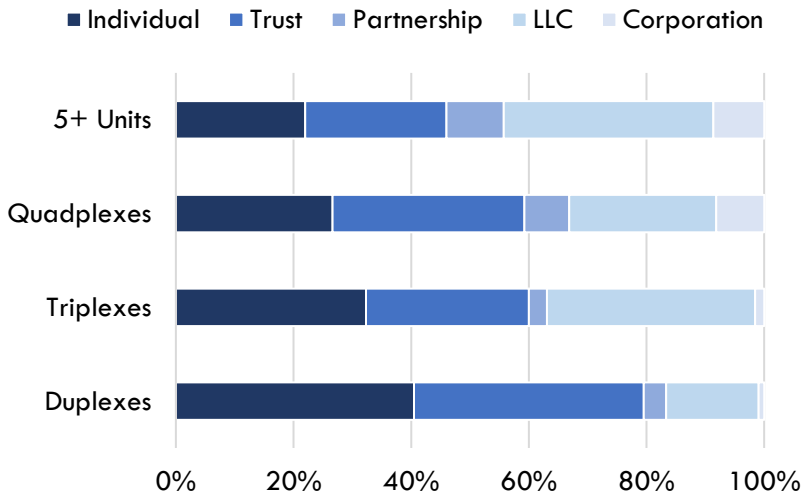
Figure 23: Beverly Hills RSO Building Ownership by Type of Entity, 2017



Source: RSO Registry (obtained March 21, 2018)

Individuals own a larger share of two- to four-unit RSO buildings than RSO Buildings with five or more units, which have a broader distribution of ownership types, as shown in Figure 24. This characteristic reflects broader real estate investment dynamics in which medium to large real estate companies and investors generally have greater access to investment capital allowing them to acquire larger apartment buildings that tend to be more expensive than smaller buildings in the same market. Conversely, individuals and small companies generally have more limited access to investment capital, and commensurately seek smaller, less expensive buildings.

Figure 24: Beverly Hills RSO Building Ownership by Type of Entity by Number of Units in Structure, 2017



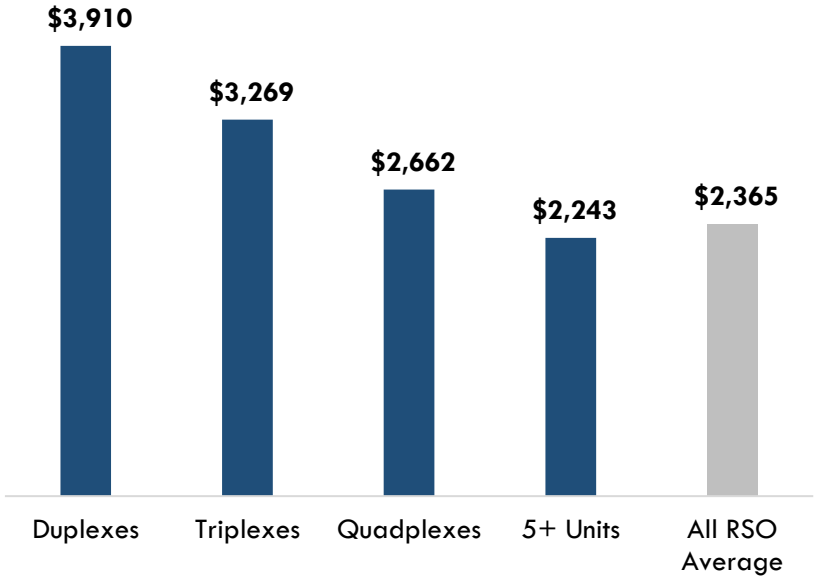
Source: RSO Registry (obtained March 21, 2018)

RENTS

As shown in Figure 25, average monthly rent for RSO Units is $2,365 per unit, and average rents inversely correlate with the number of units in a building: duplexes achieve the highest average rents of approximately $3,900 per unit per month, while buildings with five or more units achieve average rents of approximately $2,240 per unit per month. Duplexes also have higher proportions of three-bedroom units compared with other RSO Buildings types, suggesting that they tend to have larger units. As shown in Figure 26, the directional trend of average monthly rent in RSO Units has paralleled the trend for all multifamily rental units in nearby cities and the County for nearly the past two decades, but average rent in Beverly Hills has historically been higher than in those comparative areas.

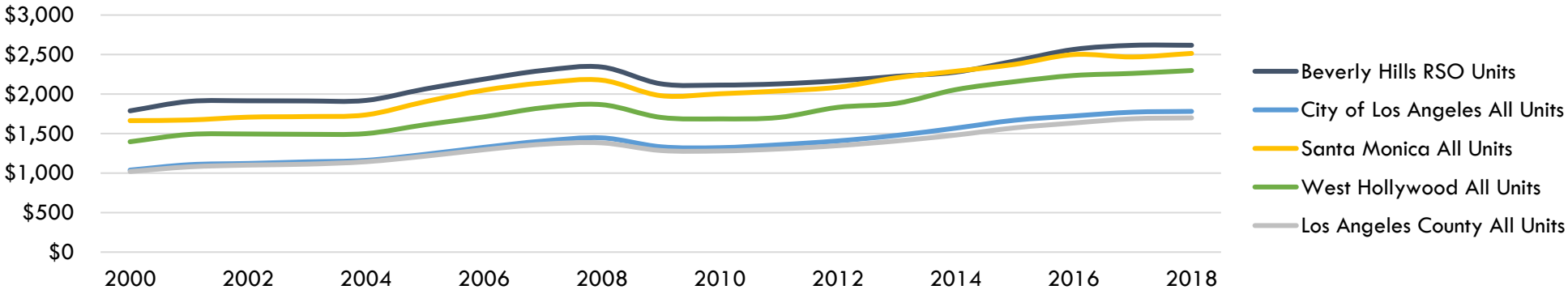
More specifically, between 2000 and 2018, average Beverly Hills RSO unit rents have fluctuated year to year, increasing as much as 7.5 percent and decreasing as much as 9.1 percent, as shown in Figure 27. On average, RSO unit rents increased a little more than two percent annually over that time.

Figure 25: Beverly Hills Average Monthly Rents per RSO Unit by Number of Units in Structure, 2017



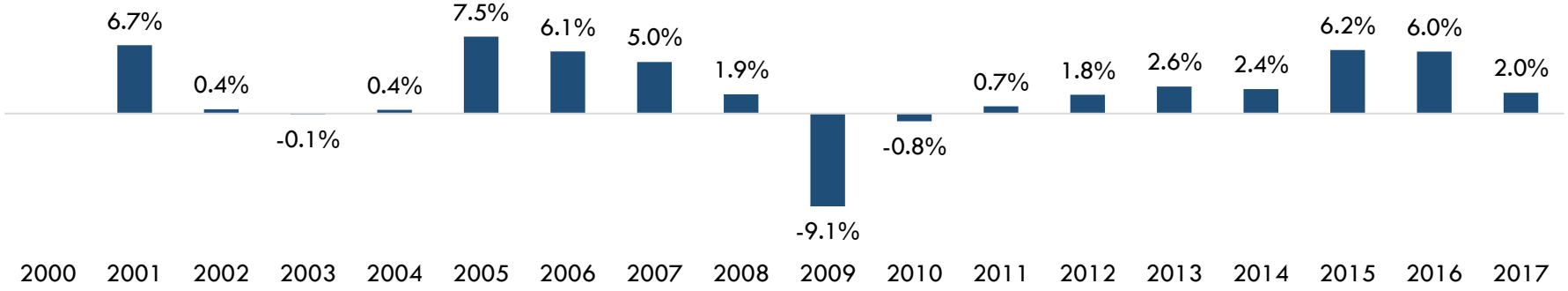
Source: RSO Registry (obtained March 21, 2018)

Figure 26: Apartment Rents per Unit, 2000-2018



Source: CoStar

Figure 27: Annual Change in Beverly Hills RSO Rents Per Unit, 2000-2017

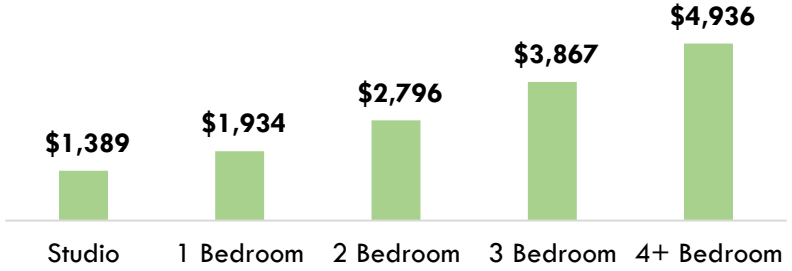


Source: CoStar

Beverly Hills RSO Units rents positively correlate with the number of bedrooms per unit, as shown in Figure 28. Studios are on the lowest end of the range and rent for $1,389 per month on average, while on the highest end of the range units with four or more bedrooms rent for an average of $4,936. As shown in Figure 29, Chapter 6 tenants pay an average of $2,427 per unit per month, which more than double the $1,017 per unit per month that Chapter 5 tenants pay on average, although Chapter 5 tenants make up only three percent of all RSO tenants, as noted previously.

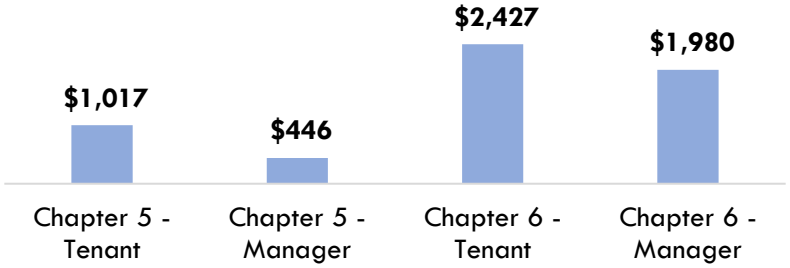
Despite Beverly Hills having historically higher rents per RSO unit among comparative areas, the City's RSO Units fall in the middle of the range among comparative areas, and very similar to West Hollywood, in terms of rents per square foot over time, as shown in Figure 30. Average rents per square foot for RSO Units in Beverly Hills are currently $2.85 and are highest in Santa Monica at $3.70, which has experienced much more new non-regulated apartment construction.

Figure 28: Beverly Hills RSO Average Monthly Rent Per Unit by Unit Type, 2017



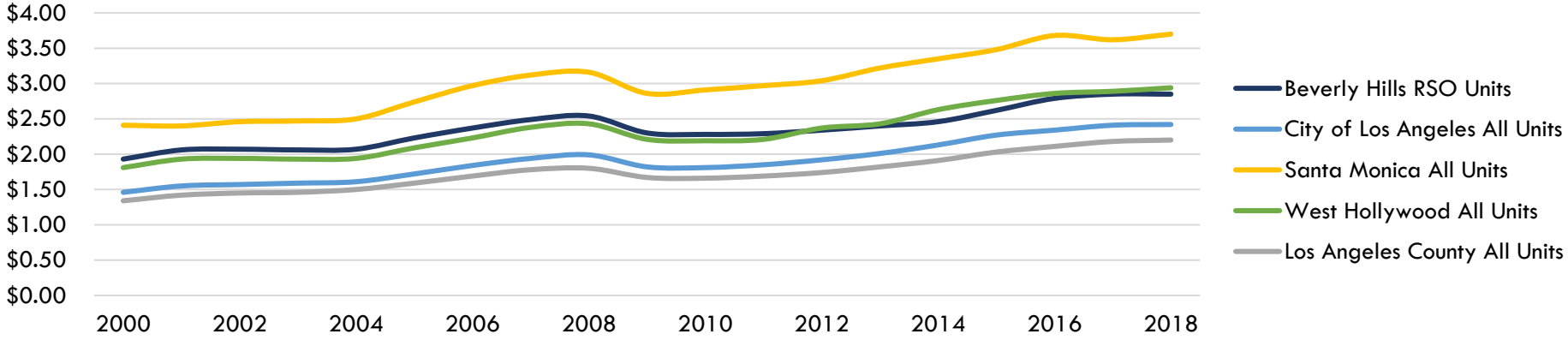
Source: RSO Registry (obtained March 21, 2018)

Figure 29: Beverly Hills RSO Average Monthly Rent Per Unit by Tenant Type, 2017



Source: RSO Registry (obtained March 21, 2018)

Figure 30: Average Monthly Apartment Rents per Square Foot, 2000-2018

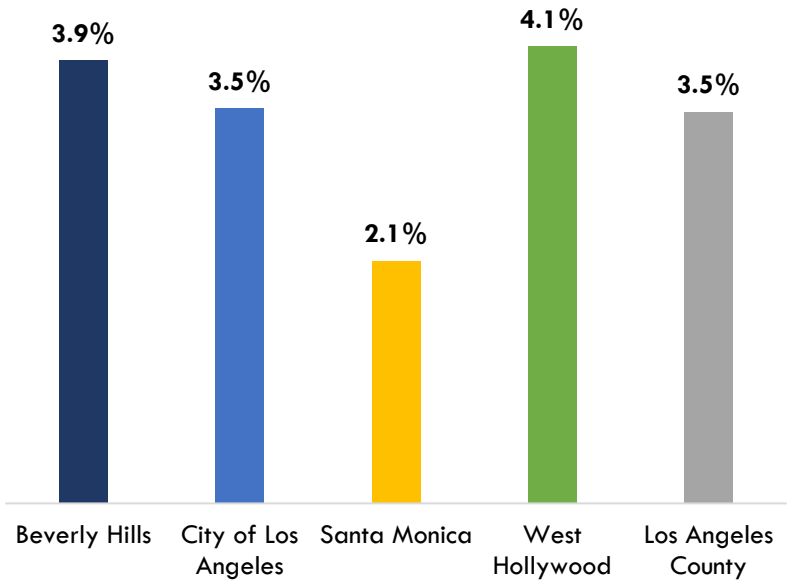


Source: CoStar

VACANCY RATES

As shown in Figure 31, the vacancy rate for all rental units in Beverly Hills is approximately 3.9 percent, which was higher than that in the County as a whole and nearby cities, except for West Hollywood, according to the 2012-2016 ACS. RSO Registry data, which reflects a snapshot at the point in time properties registered, shows that 6.6 percent of total RSO Units were vacant at the time the data were recorded. Buildings with five or more units were slightly below this average (6.4%), while buildings with less than five units were above it (7.8%). However, vacancy rates in smaller buildings are necessarily more impacted by a vacant unit than larger buildings. For example, a duplex with one vacant unit is 50 percent vacant, while a 10-unit building with one vacant unit is 10 percent vacant.

Figure 31: Vacancy Rate for All Rental Units, 2016



Source: 2012-2016 ACS

OPERATING EXPENSES

There is currently no available and authoritative source for apartment operating expense data specific to Beverly Hills. HR&A attempted to obtain operating expense data for an analytically robust and representative sample of local housing providers, but HR&A's request to the Apartment Association of Greater Los Angeles for necessary assistance in doing so was declined. In lieu of data specific to Beverly Hills apartment buildings, HR&A analyzed annual apartment income and expense data collected by the National Apartment Association ("NAA") and Institute of Real Estate Management ("IREM") for the Los Angeles Metropolitan area.

According to the NAA's 2017 income and expense profile for the Los Angeles Metropolitan Area, which includes a total of 50 properties containing 13,842 units, operating expenses for apartments are approximately one third of gross potential rent ("Gross Potential Rent"), and equal approximately $8.60 per square foot and $7,600 per unit on average, as shown in Figure 32. Taxes make up the largest share of operating expenses, followed by salaries and personnel and contract services.

While the NAA data represents the operating profile for buildings with an average of 277 units per buildings and is therefore not a strong analog for apartment buildings in Beverly Hills, which generally have between two to 44 units per building, it is useful for understanding the composition of apartment building operating budgets and provides a frame of reference for current operating expenses on a per square foot basis and in terms of the ratio of expenses to revenues.

According to IREM's expense data for apartments in the Los Angeles Metro Area[4], as shown in Figure 33, operating expenses per square foot for all apartment building types increased between 1999 and 2016, while the ratio of operating expenses to effective gross income ("EGI") has varied from year to year, but has primarily been within the range of 30 to 40 percent. Although it may vary in a given year, operating expenses are generally higher for larger buildings. Between 1999 and 2016, operating expenses per square foot averaged approximately $7.60 for high-rise buildings, $6.70 for low-rise buildings with 25 or more units, and $5.20 for low-rise buildings with 12 to 24 units. In terms of the ratio of operating expenses to EGI over the same time period, high-rise buildings had an average of 40 percent, low-rise buildings with 25 or more units had an average of 37 percent, and low-rise buildings with 12 to 24 units had an average of 33 percent.

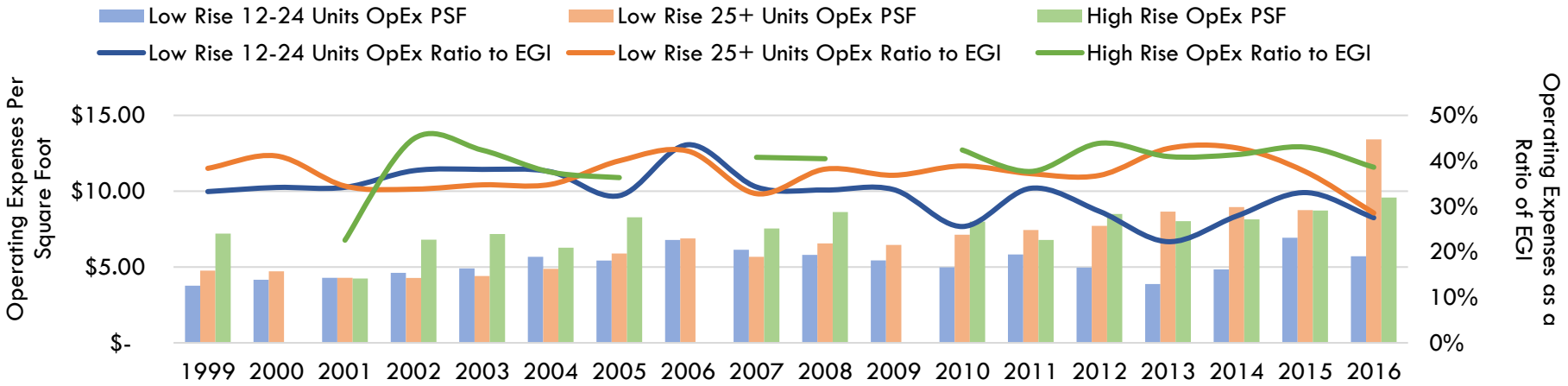
Figure 32: 2017 Los Angeles Metro Area Average Apartment Annual Income and Expense Profile, 2017

	Per Unit	Per SF	% of GPR
Revenues			
Gross Potential Rent	$23,561	$26.49	100.0%
Rent Revenue Collected	$22,277	$25.04	94.5%
Losses to Vacancy	$1,047	$1.18	4.4%
Collection Losses	$138	$0.16	0.6%
Losses to Concessions	$100	$0.11	0.4%
Other Revenue	$1,063	$1.20	4.5%
Total Revenue	**$23,340**	**$26.24**	**99.1%**
Operating Expenses			
Salaries and Personnel	$1,521	$1.71	6.5%
Insurance	$359	$0.40	1.5%
Taxes	$2,236	$2.51	9.5%
Utilities	$686	$0.77	2.9%
Management Fees	$620	$0.70	2.6%
Administrative	$411	$0.46	1.7%
Marketing	$184	$0.21	0.8%
Contract Services	$1,153	$1.30	4.9%
Repair and Maintenance	$491	$0.55	2.1%
Total Operating Expenses	**$7,662**	**$8.61**	**32.5%**

Source: NAA

[4] IREM data does not include high-rise buildings for years 2000, 2006, and 2009.

Figure 33: Los Angeles Metro Area Apartment Operating Expenses Per Square Foot and as a Ratio of Effective Gross Income ("EGI"), 1999-2016

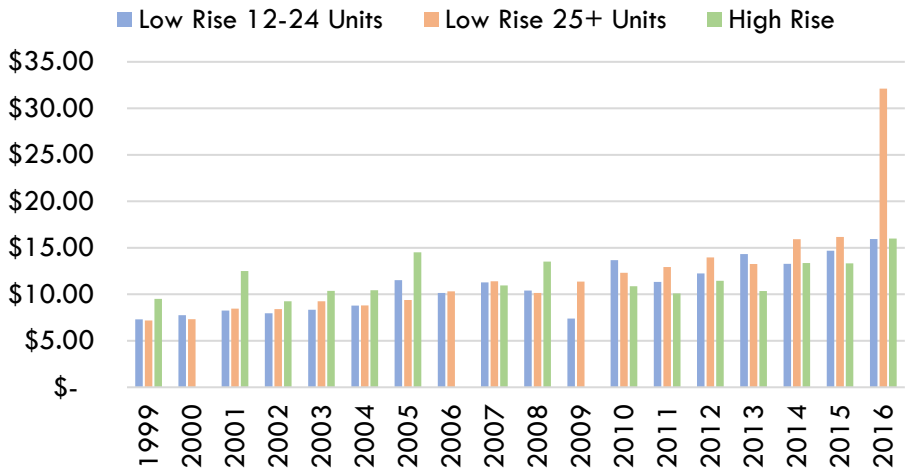


Source: IREM. Data gaps in some years reflect missing survey data.

NET OPERATING INCOME

According to IREM data, NOI has increased for all building types between 1999 and 2016, as shown in Figure 34. Similar to operating expenses, NOI tends to positively correlate with building size. Between 1999 and 2016, NOI per square foot averaged approximately $11.80 for high-rise buildings, $12.15 for low-rise buildings with 25 or more units, and $10.80 for low-rise buildings with 12 to 24 units. Low-rise buildings with 25 or more units have the highest average NOI per square foot over that time period due to a spike in 2016, but would otherwise fall in the middle of the three apartment building types. Over the same time period, year-to-year percent changes in NOI per square foot averaged 9 percent for high-rise buildings, 11 percent for low-rise buildings with 25 or more units, and 9 percent for low-rise buildings with 12 to 24 units.

Figure 34: Los Angeles Metro Area Apartment Average Net Operating Income Per Square Foot, 1999-2016



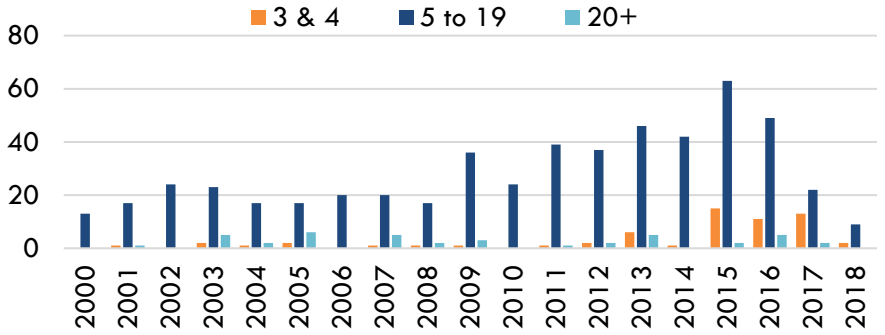
Source: IREM

APARTMENT BUILDING SALES

Despite rent restrictions, Beverly Hills RSO Buildings have historically sold for higher average prices per unit than all apartment buildings in comparative areas, according to data obtained from CoStar, as shown in Figure 35. The building sales data from CoStar for Beverly Hills include multifamily rental properties with three or more units that were built prior to 1995 (i.e., RSO Buildings) and include all multifamily rental properties for comparative cities. While prices per Beverly Hills RSO units have fluctuated over time, some years dipping below prices for all apartment buildings in Santa Monica, they have generally increased, and in 2017 (the most recent year for which data are available for Beverly Hills) sold for an average of $590,000 per unit, approximately $110,000 more than average per unit apartment prices in Santa Monica in the same year. The data suggest that the RSO has not hampered property value growth, and Beverly Hills RSO Buildings have generally sold at higher prices on average than all apartment buildings in nearby cities, which include more unregulated new construction apartment buildings.

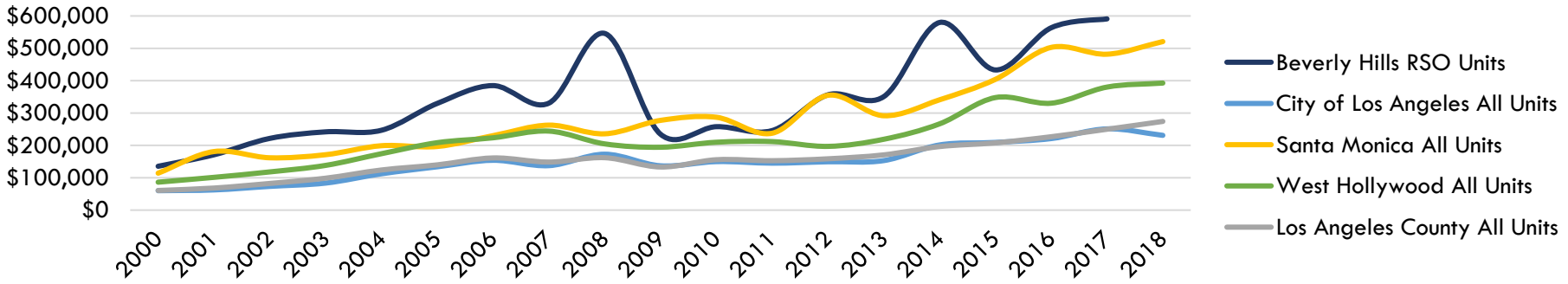
Within the City, the number of annual apartment building sales (particularly for duplexes and triplexes), remained at very modest levels between 2000 and through the Great Recession (2007-2009), as shown in Figure 36. The annual volume of multifamily sales increased for all scales of buildings beginning with the end of the recession, peaked in 2015, and has since then tailed off to levels more like the beginning of the decade. This trend also generally holds for triplexes and quadplexes, but still at much lower volumes than for buildings with more units. More specifically, there have been 535 total sales for buildings with 5 to 19 units since 2000 compared with 60 total sales for three- and four-unit buildings and 41 total sales for 20-plus unit buildings over the same period.

Figure 36: RSO Multifamily Property Sales by Number of Units in Structure in Beverly Hills, 2000-2018



Source: CoStar

Figure 35: Average Price per Apartment Unit Derived from Apartment Building Sales, 2000-2018



Source: CoStar

CONSUMER PRICE INDEX

The Consumer Price Index ("CPI") is the benchmark for allowable annual rent increases in Beverly Hills under the RSO and the RSOs of many other California cities, typically tethered to the average annual percent change within a respective metropolitan area on a year-by-year basis. The U.S. Bureau of Labor Statistics ("BLS") defines the CPI as "a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services."[5] The BLS categorizes the complete market basket that the CPI measures as "All Items" that includes subcategories for its various household cost components including "Rent of primary residence." However, the rent of primary residence subcategory necessarily only accounts for housing costs to the consumer (i.e. tenant) and does not include apartment operating costs that would be incurred by the housing provider.

All California cities that use CPI as a method for determining allowable annual rent increases refer to the CPI for Urban Consumers ("CPI-U") for All-Items for their respective metropolitan areas. According to the BLS, The CPI-U "includes expenditures by urban wage earners and clerical workers, professional, managerial, and technical workers, the self-employed, short-term workers, the unemployed, retirees and others not in the labor force."[6]

The premise for using the CPI to calibrate allowable rent increases is that it is the most widely used and accepted, most frequently updated (monthly) and most readily available measures of general price inflation.[7] Combined with the ability for housing providers to raise rents to market rates upon vacancy and income from allowed pass-throughs, maintaining rents commensurate with changes in the CPI theoretically allows for housing providers to achieve levels of net operating income that are consistent with trends in general price inflation over time, while also preserving the incentive for housing providers to maintain their properties to adequate standards.[8]

As shown in Figure 37, increases in the CPI-U for household rent have historically been higher than changes in the CPI-U for all items in the Los Angeles area, except for in 2010 and 2011 immediately following the end of the Great Recession. Between 2000 and 2017, annual percent changes in CPI-U for rent average 4.1 percent, and 2.4 percent for all items.

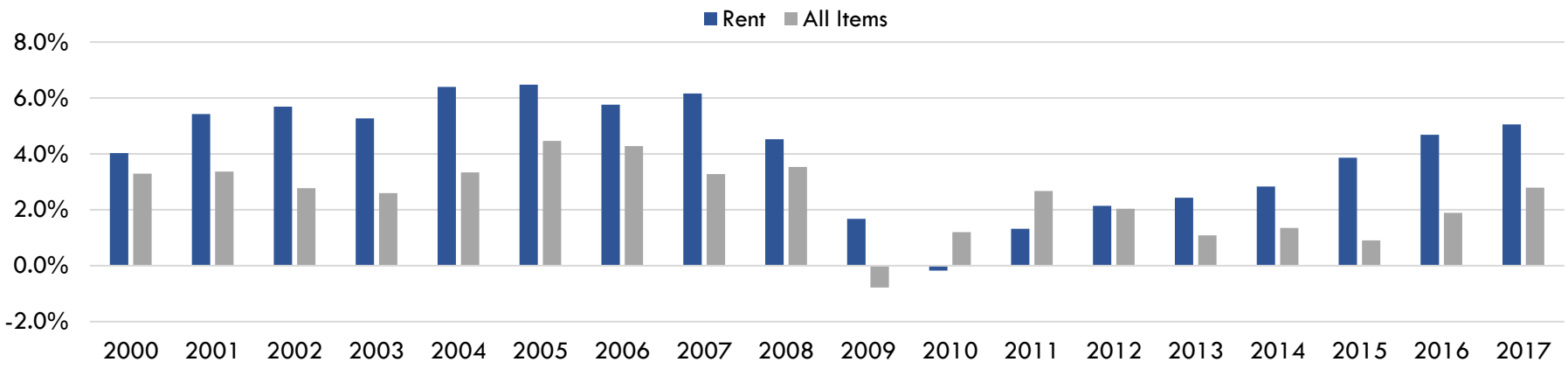
[5] United States Bureau of Labor Statistics, "Consumer Price Index," https://www.bls.gov/cpi/

[6] United States Bureau of Labor Statistics, "Consumer Price Indexes Overview," https://www.bls.gov/cpi/overview.htm

[7] Other plausible inflation indices that lack these multiple benefits include the Implicit Price Deflator, Producer Price Index and Personal Consumption Expenditure Deflator.

[8] Hamilton, Rabinovitz & Alschuler, *The 1994 Los Angeles Rental Housing Study: Technical Report on Issues and Policy Options*, p. 245.

Figure 37: Average Annual Percent Changes in the Los Angeles-Riverside-Orange County CPI-U, 2000-2017



Source: U.S. Bureau of Labor Statistics

HR&A ADVISORS, INC.
MAXIMUM ANNUAL RENT INCREASE POLICIES IN THE BEVERLY HILLS RENT STABILIZATION CONTEXT

HR&A Analyze. Advise. Act.

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DRAFT MEMORANDUM

To:	Honorable Mayor and City Council, City of Beverly Hills
From:	HR&A Advisors, Inc.
Date:	July 26, 2018
Re:	Maximum Annual Rent Increase Policies in the Beverly Hills Rent Stabilization Context

The City of Beverly Hills (the "City" or "Beverly Hills") retained HR&A Advisors, Inc. ("HR&A") to provide independent research and analysis about seven policy issues related to recently enacted changes to the City's Rent Stabilization Ordinance (the "RSO").[1] This Issue Paper addresses whether, and if so how, the City Council might consider amending the RSO or other sections of the City's Municipal Code to adjust its policies for regulating the maximum allowable annual rent increases for RSO units.

The Issue Paper begins with a general statement about the issue as it has arisen in the context of the RSO, describes the City's current policies on allowable rent increases, highlights related positions mentioned in public discussions about the RSO Amendments, and summarizes how this issue is addressed by 13 other California cities with rent regulation, based on a review of their ordinances and regulations and through discussions with several of those cities' representatives. The Issue Paper then presents data from various sources that have a bearing on the issue, including the U.S. Bureau of Labor Statistics ("BLS"), CoStar Group, Inc., and the Institute of Real Estate Management ("IREM"). Based on the information and data provided on this topic, the Issue Paper concludes with a set of plausible policy options for City Council, City staff, and public consideration.

Statement of the Issue

An essential feature of any rent regulation system is the maximum percentage and/or dollar amount by which rents are allowed to change each year. In setting the allowable change, local governments generally attempt to balance protecting tenants from excessive rent increases with the ability of housing providers to earn a "fair return," typically defined in terms of sufficient income to pay for ongoing costs of operating their apartment buildings.[2] Cities seek to strike this balance in different ways; there is no objectively correct mechanism, structure, or percentage by which rent increases can be regulated. Rather, there are many possible approaches to setting allowable rent increase amounts.

In addition to the basic structure and formula used to set allowable annual rent increases, some cities also allow costs for specified categories of capital improvements and/or operating expenses (e.g., cost of utilities

[1] Ordinance Number 17-O-2729, adopted in April of 2017 (the "RSO Amendments"). The City's Rent Stabilization Ordinance (the "RSO") regulations are included in Beverly Hills Municipal Code ("BHMC") Title 4, Chapter 5 ("Chapter 5") and Chapter 6 ("Chapter 6"). Tenants residing in RSO units subject to regulation under Chapter 5 are hereinafter referred to as "Chapter 5 Tenants;" and Tenants residing in RSO units subject to regulation under Chapter 6 are hereinafter referred to as "Chapter 6 Tenants."

[2] See Attachment A for an analysis of the standard of "fair return" and how it has been interpreted by the courts in a rent regulation context by Dr. Kenneth Baar, a lawyer and recognized expert on the subject.

and property taxes) to be passed through to tenants in the form of rent surcharges, which contributes to housing provider incomes. These provisions specify how housing providers may "pass through" eligible expense items, ranging from a relatively simple process that requires only submittal of evidence for increased costs (e.g. utility bills, government fee charges, etc.) and advanced notice to the affected tenant(s), to a more extensive process requiring independent review by a hearing officer, mediator, or some other governmental or third-party official, or a review body.

Another important consideration in setting the allowable annual rent increase is additional income housing providers receive when they raise rents to market rates if a unit is voluntarily vacated, which is known as "vacancy decontrol." California cities are required to permit vacancy decontrol under the provisions of the Costa-Hawkins Rental Housing Act of 1995 ("Costa Hawkins"),[3] although cities may impose controls on annual rent increases until that same tenant voluntarily moves.[4] According to the U.S. Census Bureau's American Community Survey 5-Year Estimates for 2012-2016, approximately 24 percent of renters in Beverly Hills moved into their unit within the past year,[5] suggesting (since nearly all multi-family rentals in the City are subject to the RSO) that nearly a quarter of all RSO rental units in the City may turnover in a given year, whereupon rents may be reset to market rate if vacated voluntarily.

One of the key changes of the RSO Amendments was to limit the ability for housing providers in Beverly Hills to increase annual rents for Chapter 6 tenants by *the greater of* the annual percent change in the CPI for Los Angeles-Riverside-Orange County ("LA Area CPI") or 3.0 percent, as compared with the 10.0 percent annual rent increase previously allowed by the original 1978 RSO.

During a series of professionally-facilitated dialogue sessions between Beverly Hills housing providers and tenants living in buildings subject to the RSO, following adoption of the RSO Amendments, tenants articulated a collective position that allowable annual rent increases under Chapter 6 should match the annual percentage change in the LA Area CPI, with a maximum allowable increase of 8.0 percent.[6] This proposed allowable rent increase provision would make Chapter 6 consistent with Chapter 5 policy. Tenants further argued that the allowable annual rent increase should be based on the LA Area CPI only, and not based on a negotiated fixed percentage or a "random number," and approval for rent increases should be contingent on maintaining at least minimum acceptable habitability standards.[7]

Housing providers articulated a collective position that the allowable annual increase should be a fixed percentage of either 6.0 percent or 5.1 percent with automatic passthroughs of utility costs to tenants, but without requiring formal approval from the City to do so.[8] A more recent communication from some housing

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[3] California Civil Code, sections 1954.50 to 1954.535.

[4] Proposition 10 on the November 2018 statewide ballot seeks to repeal Costa Hawkins.

[5] American Community Survey 5-Year Estimates, 2012-2016, Table B07013. Geographical Mobility In The Past Year By Tenure For Current Residence In The United States.

[6] City of Beverly Hills Human Services Division Memorandum, "Rent Stabilization Update," September 28, 2017, Attachment 1, p.22. http://beverlyhills.granicus.com/MetaViewer.php?view_id=40&clip_id=5787&meta_id=344485 ("Rent Stabilization Update")

[7] Ibid.

[8] City of Beverly Hills Human Services Division Memorandum, "Rent Stabilization Update," September 28, 2017, Attachment 1, p.21. http://beverlyhills.granicus.com/MetaViewer.php?view_id=40&clip_id=5787&meta_id=344485

provider representatives expressed a preference for a 7.0 percent maximum, although housing providers did not offer a basis for this number.[9] Housing providers also stated that they do not agree that CPI is an appropriate benchmark for allowable rent increases.[10]

The Current Beverly Hills Context

The City's RSO classifies tenants of buildings subject to the RSO as either Chapter 5 Tenants, who are those with original rent contracts of $600 or less per month and live in buildings constructed prior to September 20, 1978[11]; or Chapter 6 Tenants, who are those with original rent contracts that exceed $600 per month and live in buildings built before February 1, 1995. Under Chapter 5, housing providers may increase rents by *the lesser of* 8.0 percent or the percentage that results from taking the difference of the sum of the LA Area CPI for the 12 months preceding the most recent 12 months, and dividing that difference by the lesser of the two 12 month period sums. Under Chapter 6, housing providers may increase rents by *the greater of* 3.0 percent or the percentage change in the LA Area CPI between May of the most recent year and May of the preceding year. Chapter 6 limits vacancy decontrol for voluntarily vacated units only. Units vacated due to no-fault evictions must remain at the same rent for the next occupant. Additionally, both Chapter 5 and Chapter 6 limit rent increases to once every 12 months and permit housing providers to petition for rent increases beyond the allowable percentage amount through a rent increase application process, which is the subject of a separate HR&A Issue Paper.

Both Chapter 5 and Chapter 6 permit housing providers to pass through certain expense items without undertaking a rent increase application process, but the provisions are not identical. As shown in Figure 1, Chapter 5 and Chapter 6 both allow housing providers to pass through 90 percent of the cost of water penalty surcharges and the full cost of refuse fees imposed by the City, but Chapter 5 also allows housing providers to pass through specified amounts of capital expenditure surcharges, any government mandated improvements, utility expense surcharges, and property taxes (by approval of a hearing officer) at the time of the annual rent increase. If utilized, these passthroughs can result in rent increases that are greater than the annual percentage change permitted by Chapter 5 and Chapter 6, although the impact of these additional increases is difficult to quantify because the expenses are generally unique to each rental property. Relatedly, at this time, Beverly Hills is the only city that does not charge fees for required rent registration. Many cities that charge fees to housing providers for rent registration also allow housing providers to pass a portion of these fees through to tenants, pursuant to state law and judicial decisions.

[9] Rental Property Owners of Beverly Hills, "Letter to Mayor Gold and Councilmember Wunderlich," July 6, 2018.

[10] Rent Stabilization Update, *op. cit.*

[11] Beverly Hills Municipal Code 4-5-102.

Figure 1: Summary of Allowable Passthroughs for Chapter 5 and Chapter 6

Passthrough	Chapter 5	Chapter 6
Water Service Penalty Surcharge	90% of cost of surcharge	90% of cost of surcharge
Refuse Fee Surcharge	100% of cost of surcharge	100% of cost of surcharge
Capital Expenditure Surcharge	No greater than 4% of base rent	-
Improvement Expenses Mandated by Law	18% of cost including interest of value of capital	-
Utility Expense Surcharge	Difference between the percentage change in utility expenses and allowable rent increase	-
Property Tax Increase	5% of base rent for a maximum of 3 years; must be approved by hearing officer	-

Source: BHMC Title 4, Chapter 5 and Chapter 6

Comparison with Other Cities in California

Among the 14 California cities with residential rent regulation programs, including Beverly Hills, the range of approaches for setting maximum allowable annual rent increases includes the following:

- Setting allowable rent increases based on a specified percentage of annual change in the CPI;
- Setting allowable rent increases based on a specified percentage of annual changes in the CPI, but with a minimum and/or maximum percentage (i.e., a "floor and ceiling") by which rents may be increased annually regardless of changes in the CPI;
- Setting annual increases based on a specified percentage of annual change in the CPI, but subject to a fixed dollar amount each year up to which rents may be increased; and
- Setting a fixed percentage without reference to the CPI, up to which rents may be increased annually.

As shown in Figure 2, 12 of 14 cities, including Beverly Hills, use CPI to set allowable rent increases, and only two apply fixed percentages other than the CPI, both of which use 5.0 percent as the fixed maximum. Among the 12 cities that use CPI, seven base allowable rent increases on a fraction of the total annual percentage change in CPI, ranging from 60 to 80 percent. Like the Chapter 5 provisions, seven of the 12 cities that use CPI also have allowable maximum rent increases, ranging from five to 10.0 percent, and, like the Chapter 6 provisions, three have an allowable minimum increase, ranging from 2.0 to 3.0 percent. In addition to using the CPI, Santa Monica considers setting a maximum fixed dollar amount by which rents may be increased.

Figure 2: Comparison of Allowable Rent Increase Approaches and Percentages in California Cities with Rent Regulation

City	Fixed Percentage	Fixed Dollar Amount	CPI	Applicable Percentage of CPI	Allowable Minimum Increase	Allowable Maximum Increase[1,2]
Beverly Hills -- Chapter 5			✓	100%	-	8%
Beverly Hills -- Chapter 6			✓	100%	3%	-
Berkeley			✓	65%	-	-
East Palo Alto			✓	80%	-	10%
Hayward	✓			-	-	5%
Los Angeles			✓	100%	3%	8%
Los Gatos			✓	70%	-	5%
Oakland			✓	100%	-	10%
Mountain View			✓	100%	2%	5%
Palm Springs			✓	75%	-	-
Richmond			✓	100%	-	-
San Jose	✓			-	-	5%
San Francisco			✓	60%	-	7%
Santa Monica		✓	✓	75%	-	-
West Hollywood			✓	75%	-	-

[1] For cities that use CPI, this would be expressed as the lesser of the allowable maximum percentage increase or the relevant percent change in CPI.
[2] Does not include the allowable maximum increase with rent "banking."

Source: HR&A Advisors, Inc. and the individual cities

In addition to annual allowable increases, as noted above, cities with rent regulation also often enable housing providers to pass through some amount of specified expenses to tenants without undergoing a formal rent increase application process. Cities place a variety of restrictions on such expense pass-throughs, including the share of costs that may be passed through to tenants, how frequently expenses may be passed through, and what types of expenses may be passed through.

As shown in Figure 3, nearly two-thirds of California cities with rent regulation allow housing providers to pass through at least some of the costs of RSO registration and/or administration fees, and half allow some utility expenses to be passed through, often related to one-time water penalty surcharges or ongoing water assessments. A little over one-third of these 14 cities allow capital expenditures to be passed through without a formal petition process. It is more common that cities require capital expenditure passthroughs to be approved through a formal rent increase application process. Lastly, over 40 percent of these cities allow housing providers to pass through other expenses and fees, such a voter-approved indebtedness (e.g., municipal bonds and school facility bonds), special assessments (e.g., street lighting and maintenance districts and parcel taxes), property taxes in general, among others. However, the Santa Monica Rent Control Board voted in June 2018 to phase out the ability to pass through expenses on voter-approved indebtedness and

property taxes as these expenses have increased significantly in recent years, due to the combined effects of more such voter measures and increases in property sales with associated increases in assessed valuation, which figures in the cost of the voter-approved debt issues.[12] Santa Monica's new regulations eliminate property tax and voter-approved indebtedness surcharges for tenancies that begin after March 1, 2018, or if property ownership changes or if a property is reassessed, regardless of the duration of tenancy.[13] The regulations also limit these same surcharges to a maximum of $35 per unit for tenancies that began prior to March 1, 2018.[14]

Figure 3: Comparison of Generalized Allowable Pass-Through Expense Categories That Do Not Require a Rent Increase Application Process Among California Cities with Rent Regulation

City	Capital Expenses	Utilities	RSO Registration or Administration Fees	Other City-Imposed Fees
Beverly Hills -- Chapter 5	✓	✓		✓
Beverly Hills -- Chapter 6		✓		
Berkeley			✓	
East Palo Alto	✓	✓	✓	
Hayward		✓	✓	✓
Los Angeles[1]	✓	✓	✓	✓
Los Gatos	✓		✓	
Oakland	✓		✓	
Mountain View				
Palm Springs			✓	
Richmond				
San Jose				✓
San Francisco		✓		✓
Santa Monica			✓	✓
West Hollywood		✓	✓	
Percentage	**36%**	**50%**	**71%**	**43%**

[1] Allowable pass-through for Systematic Code Enforcement Program ("SCEP") fees, which are charged to all multifamily residential rental property owners in the City of Los Angeles, is included under the "Other City-Imposed Fees" column.

Source: HR&A Advisors, Inc. and the individual cities

[12] Santa Monica Rent Control Board Memorandum, "Administrative Item to amend Regulations 3105, 3106, 3108, 3109, and 3120, respecting surcharges, to conform these regulations with amendments previously adopted by the Board," July 12, 2018; https://www.smgov.net/uploadedFiles/Departments/Rent_Control/About_the_Rent_Control_Board/Staff_Reports/2018/Item%2012A%20Chapter%203%20Regulations.pdf

[13] Ibid.

[14] Ibid.

Consumer Price Index as a Benchmark for Allowable Annual Increases

As discussed in the preceding section, annual percentage change in the CPI is the predominant mechanism by which California cities with rent regulation systems benchmark allowable annual rent increases. The U.S. Bureau of Labor Statistics ("BLS") defines the CPI as "a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services."[15] The BLS categorizes the complete market basket that the CPI measures as "All Items," which includes subcategories for its various household cost components including "Rent of primary residence." However, the rent of primary residence subcategory necessarily only accounts for housing costs to the consumer (i.e. tenant) and does not include apartment operating costs that would be incurred by the housing provider. All 12 California cities that use CPI as a method for determining allowable annual rent increases refer to the CPI for All-Items for their respective metropolitan areas.

The premise for using the CPI to calibrate allowable rent increases is that it is the most widely used and accepted, most frequently updated (monthly) and most readily available measures of general price inflation.[16] Combined with the ability for housing providers to raise rents to market rates upon voluntary vacancy (i.e. "vacancy decontrol") and income from allowed pass-throughs, maintaining rents commensurate with changes in the CPI theoretically allows for housing providers to achieve levels of net operating income that are consistent with trends in annual operating expense price inflation over time, while also preserving the incentive for housing providers to maintain their properties to adequate standards.[17]

One alternative to using CPI as a benchmark for rent regulation is developing and annually updating a weighted index of annual apartment operating costs. However, a study prepared in 2016 for the City of San Jose points out that such operating cost studies are resource- and time-intensive, require the annual preparation of the study, annual hearings to consider the studies, and deliberation regarding the appropriate rent increase amount resulting from the data.[18] Moreover, previous operating cost studies have reached the same or similar outcomes that would have otherwise resulted from the application of the percentage change in CPI. Largely for this reason, Santa Monica abandoned this approach, which had been in use between 1979 and 2012, in favor of a percentage of the CPI and consideration of an annual dollar amount cap.[19]

CPI, Rent, and Operating Expense Data

As shown in Figure 4, annual percent changes in the Los Angeles area CPI have averaged 2.4 percent between 2001 and 2017, reaching as low as -0.8 percent during the Great Recession and as high as 4.5 percent. Had the current Chapter 6 provisions been in place over this time, the CPI percentage change would have only exceeded 3.0 percent in 2001 and from 2004 to 2008, meaning that rents would only have been

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[15] United States Bureau of Labor Statistics, "Consumer Price Index," https://www.bls.gov/cpi. There are two primary CPI measures: All Urban Consumers and Urban Wage Earners and Clerical Workers. Most rent regulation systems that reference the CPI use All Urban Consumers.

[16] Other plausible inflation indices that lack these multiple benefits include the Implicit Price Deflator, Producer Price Index and Personal Consumption Expenditure Deflator.

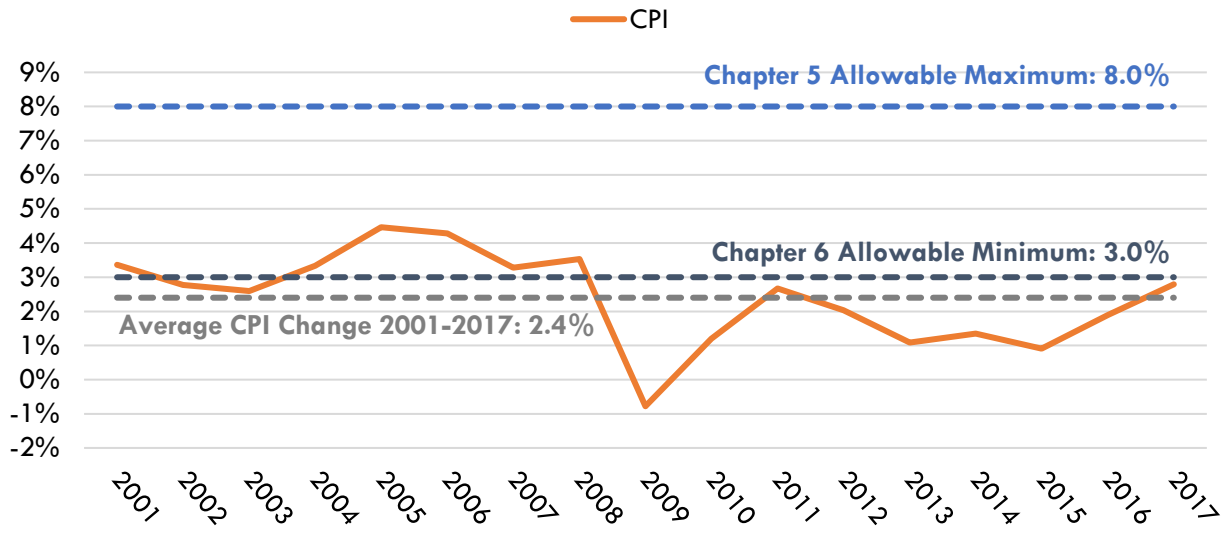
[17] Hamilton, Rabinovitz & Alschuler, *The 1994 Los Angeles Rental Housing Study: Technical Report on Issues and Policy Options*, p. 245.

[18] Economic Roundtable, *San Jose ARO Study,* April 2016, p. 86; https://www.sanjoseca.gov/DocumentCenter/View/55649

[19] City of Santa Monica Charter, Article XVIII, Section 1805 (a) and (b), amended by voter initiative, Nov. 6, 2012.

allowed to be increased by 3.0 percent in all other years between 2001 and 2017. Additionally, this also means that Chapter 5 rents were not allowed to increase at all in 2009, and the CPI has come only within 3.5 percentage points of the allowable 8.0 percent maximum under Chapter 5.

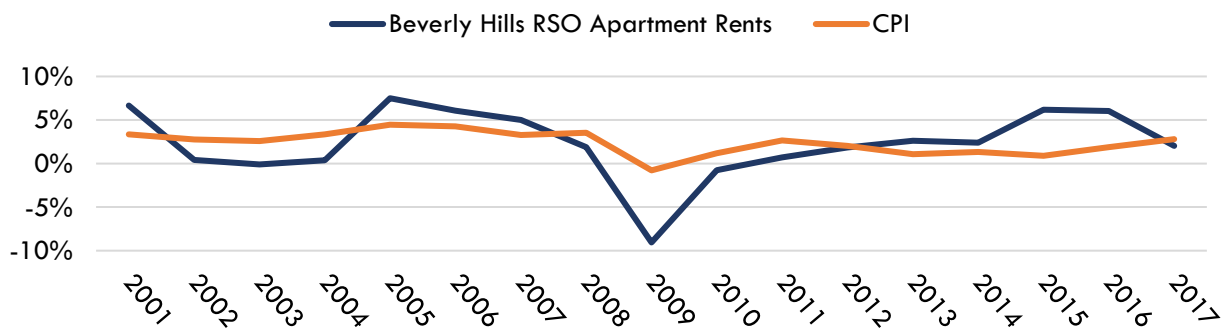
Figure 4: Average Annual Percent Changes in the Los Angeles-Riverside-Orange County CPI - All Items, 2001-2017



Source: HR&A Advisors, Inc; United States Bureau of Labor Statistics

As shown in Figure 5, annual increases in average per unit rents for Beverly Hills RSO units fluctuated more dramatically than changes in the CPI between 2001 to 2017, ranging from a steep -9.1 percent drop during the Great Recession to a 7.5 percent increase in 2005, but averaging a 2.3 percent annual increase over this period. Additionally, when accounting for only the years in which there was a positive percentage change in rents, the average annual increase was still just 3.5 percent. It should be noted that these rent data reflect both tenants who may have renewed leases and would therefore have had regulated rents, as well as the approximately 24 percent of units that turnover annually and may have leased at market rates pursuant to vacancy decontrol. There are no available data on how often individual housing providers sought and/or charged the then-maximum 10.0 percent rent increases for Chapter 6 Tenants prior to the RSO Amendments.

Figure 5: Average Annual Percent Changes in Beverly Hills RSO Rents Per Unit and the Los Angeles-Riverside-Orange County CPI - All Items, 2001-2017



Source: HR&A Advisors, Inc; United States Bureau of Labor Statistics; CoStar Group, Inc.

When considering regulating apartment rents by using percentage increases, however they are determined, it is important to account for the power of compounding, which can cause distortions in pricing for similar units, depending on the duration of tenancy. For example, Figure 6 shows the impact of growing Beverly Hills RSO and Los Angeles County rents at a fixed rate of 5.0 percent over 10 years. Average monthly Beverly Hills RSO rents per unit are currently $900 higher than the average for LA County as a whole. After 10 years of growth at 5.0 percent per year, this difference in rent would grow to nearly $1,470 per unit in 2028, a total net increase of approximately $570. Santa Monica's combination of a CPI-based allowable annual increase with a maximum allowable fixed dollar amount increase is intended to address the power of compounding so that lower and higher rent units receive relatively comparable rent protections on a nominal basis.

Figure 6: Illustrative Per Unit Rent Growth for Beverly Hills RSO and Los Angeles County Apartments at an Annual Rate of 5% Over a 10-year Period

Year	Beverly Hills	LA County	Difference
2018	$2,600	$1,700	$900
2019	$2,730	$1,785	$945
2020	$2,867	$1,874	$992
2021	$3,010	$1,968	$1,042
2022	$3,160	$2,066	$1,094
2023	$3,318	$2,170	$1,149
2024	$3,484	$2,278	$1,206
2025	$3,658	$2,392	$1,266
2026	$3,841	$2,512	$1,330
2027	$4,033	$2,637	$1,396
2028	$4,235	$2,769	$1,466
Total 10-Year Increase	**$1,635**	**$1,069**	**$566**

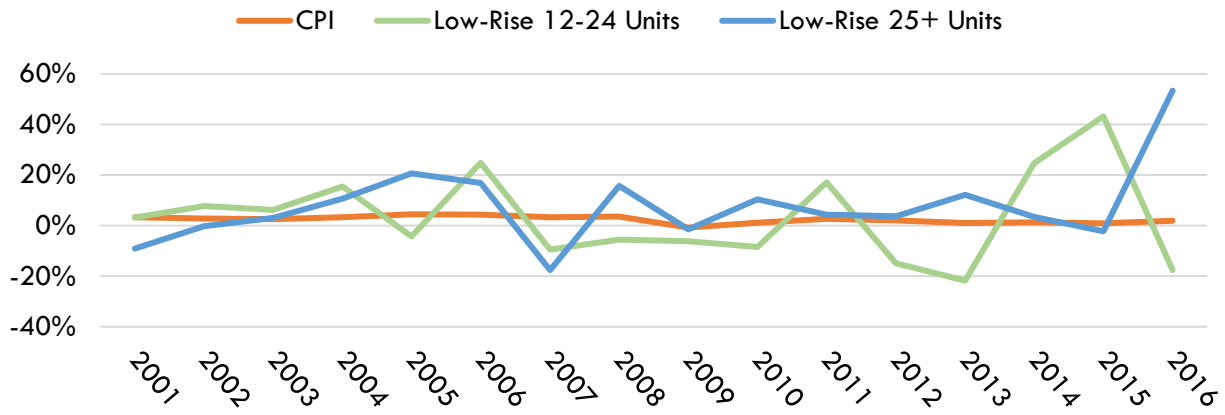
Source: HR&A Advisors, Inc; CoStar Group, Inc.

There is currently no independent, authoritative source for apartment operating expense data specific to Beverly Hills.[20] However, IREM provides operating expense trends for Los Angeles Metropolitan area apartments, categorized as properties that are low-rise (three stories or less) with 12 to 24 units or low-rise with more than 24 units.[21] As shown in Figure 7, annual percent changes in median operating expenses per square foot for apartments in the Los Angeles Metropolitan area have varied substantially year by year from 2001 to 2016, and increased by 4.0 percent on average for low-rise buildings with 12 to 24 units and 7.0 percent for those with more than 24 units.

[20] HR&A sought assistance from the Apartment Association of Greater Los Angeles ("AAGLA") to encourage its members with buildings in Beverly Hills to participate in a confidential apartment operating expenses survey designed by HR&A, but AAGLA declined to do so. HR&A's experience with similar surveys suggests that absent such industry encouragement, survey responses would be very low and non-representative.

[21] IREM also provides data for high-rise apartments, defined as four or more stores with an elevator, but these data are excluded here as these properties do not reflect Beverly Hills RSO housing stock and data for these properties are unavailable for several years.

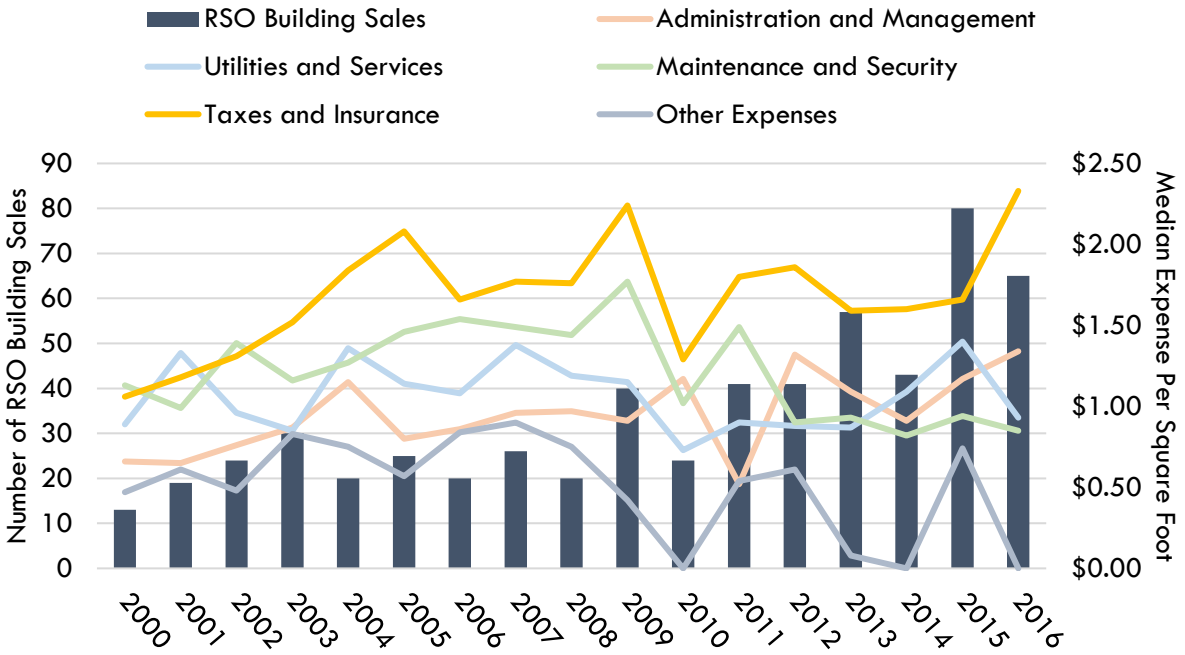
Figure 7: Average Annual Percent Changes in Los Angeles Metropolitan Area Median Apartment Operating Expenses Per Square Foot and the Los Angeles-Riverside-Orange County CPI - All Items, 2001-2016



Source: HR&A Advisors, Inc; United States Bureau of Labor Statistics; Institute of Real Estate Management

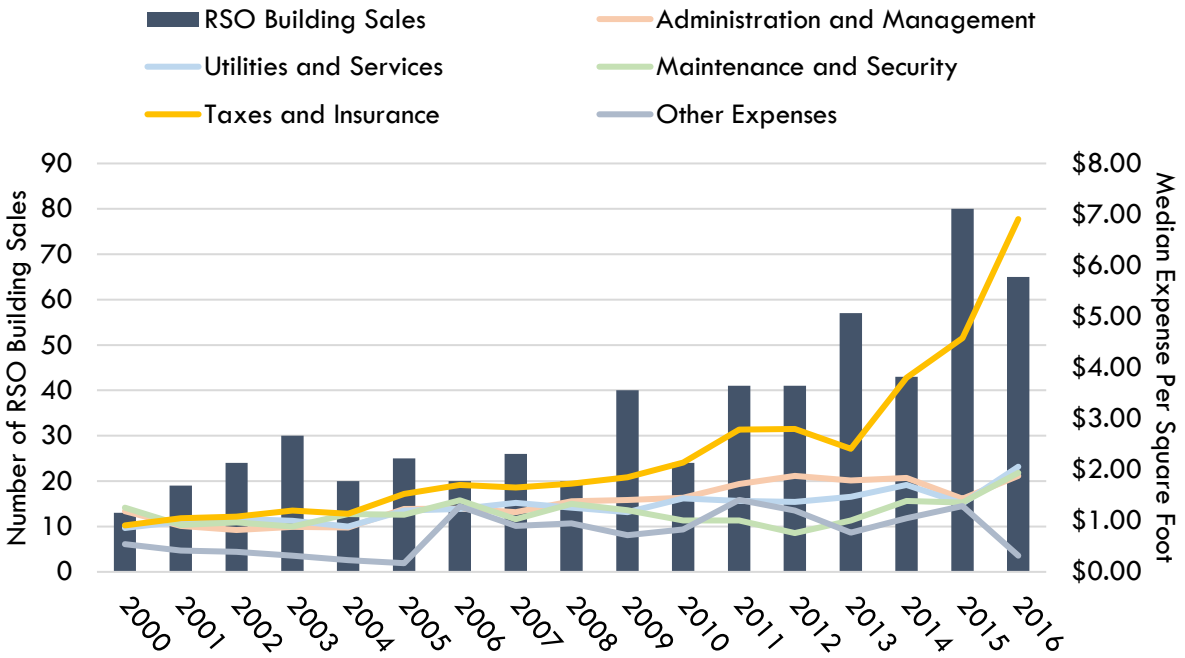
The recent spikes in the percentage change in operating expenses shown in Figure 6 are likely attributable to higher property taxes as a result of increased apartment building sales volume. Due to Proposition 13 passed by California voters in 1978, property taxes may not exceed 1.0 percent of a property's assessed value and assessed value may only increase by a maximum of 2.0 percent per year, unless a property is sold or if major physical changes are made like demolition, new construction, or a major remodel, at which point the property is reassessed at current market value. Therefore, a recent spike in the number of apartment building sales would result in increased property tax burdens for recently purchased apartment buildings, and a resulting increase in total operating expenses. As shown in Figures 8 and 9, median annual expenses per square foot for taxes and insurance for properties in the Los Angeles Metro Area increased as Beverly Hills RSO apartment building sales volume increased, while costs of all other apartment operating expense components for properties in the Los Angeles Metro Area have remained at relatively constant levels between 2000 and 2016, according to the IREM data. Importantly, as noted in the discussion of allowable passthroughs above, Chapter 5 allows housing providers to request rent increases of up to five percent of apartments base rents for a maximum of three years through a hearing officer process. Housing providers may also request from the hearing officer additional time to apply increased rents.

Figure 8: Beverly Hills RSO Apartment Building Sales and Change in Los Angeles Metropolitan Area Median Apartment Operating Expense Components Per Square Foot for Low-Rise Buildings with 12-24 units, 2000-2016



Source: HR&A Advisors, Inc; CoStar Group, Inc.; Institute of Real Estate Management

Figure 9: Beverly Hills RSO Apartment Building Sales and Change in Los Angeles Metropolitan Area Median Apartment Operating Expense Components Per Square Foot for Low-Rise Buildings with 25+ units, 2000-2016



Source: HR&A Advisors, Inc; CoStar Group, Inc.; Institute of Real Estate Management

Policy Options for Beverly Hills

As mentioned previously, there is no single objectively correct mechanism, structure, or percentage by which rent increases can be regulated. In summary, the foregoing information and data provide the following key considerations when weighing potential policy changes related to allowable rent increase and pass-through provisions in Beverly Hills:

- Both Chapter 5 and Chapter 6 allow limited pass-throughs without requiring housing providers to undergo a rent increase application process, but Chapter 6 pass-through allowances are more limited;
- Chapter 6 has allowable annual rent increase provisions that are more generous to housing providers than Chapter 5;
- Nearly all California cities with rent regulation use CPI, typically also applying an allowable annual maximum percentage or dollar amount increase;
- A majority of California cities with rent regulation charge RSO registration and/or administration fees, and allow housing providers to pass through a portion of these costs to tenants pursuant to state law and judicial decisions;
- Half of California cities with rent regulation allow housing providers to pass through some amount of utility expenses;
- Annual percent changes in CPI averaged 2.4 percent between 2001 and 2017, and increased as high as 4.5 percent over that time; and
- A recent increase in apartment building sales has resulted in an increase in property taxes as a proportion of apartment operating expense budgets

Considering these key points, HR&A suggests that there are at least seven plausible policy options that the City Council, City staff, and the public could consider when determining whether, and if so how, to address allowable annual rent increases (some of which could be combined with one another):

1. **No Policy Change:** In this case, the City would continue to allow annual rent increases of *the lesser of* the percent change in CPI or 8.0 percent for Chapter 5 Tenants and *the greater of* the percent change in CPI or 3.0 percent for Chapter 6 tenants.
    - **Advantages to housing providers:** Under current requirements, Chapter 6 housing providers would be assured of the legal ability to increase rents by at least 3.0 percent each year, and would be able to benefit from strong markets when the change in CPI exceeds 3.0 percent. Chapter 5 housing providers would maintain the ability to benefit from years when there are high increases in CPI up to 8.0 percent.
    - **Disadvantages to housing providers:** Chapter 5 housing providers would continue to rely on changes in CPI to increase rents, meaning that rents may not be allowed to increase in years when the CPI does not increase. In addition, housing providers may not be able to cover costs and could not use extreme rent increases to compel tenants to move voluntarily.
    - **Advantages to tenants:** Chapter 5 Tenants would continue to be subject to rent increases dictated by changes in CPI, potentially resulting in very low or no rent increases in some years. Chapter 6 Tenants would maintain a degree of certainty that future rent increases will be no lower than 3.0 percent, and may be higher in some years during strong economic periods when changes in CPI are above 3.0 percent.

- **Disadvantages to tenants:** Continuing to use only a percentage change as the benchmark for allowable rent increases will disadvantage tenants who already pay higher rent amounts due to the power of compounding and resulting in a disparity in nominal rent increases between tenants with currently low rents versus those who pay higher rents. Chapter 6 Tenants also would not receive the benefit of years when the CPI change is below 3.0 percent, as this is an allowable minimum rent increase that Chapter 6 housing providers may seek. With reduced maximum allowable annual rent increase, tenants can expect that their rent would be increased every year, when they may have not previously received annual increases when the maximum annual rent increase was 10 percent.

Administrative Considerations: This option would not create a need for additional staff time or other resources. However, as the RSO Amendments have been in effect for slightly more than a year, it is unknown whether housing providers would submit rent increase applications more frequently in future years, which could cause an increase in City costs.

2. **Set a maximum dollar amount by which rents may be increased annually, coupled with the existing allowable increases based on CPI:** In this case, the City would continue to allow annual rent increases of the lesser of the percent change in CPI or 8.0 percent for Chapter 5 Tenants and the greater of the percent change in CPI or 3.0 percent for Chapter 6 tenants, but would also annually establish a maximum dollar amount up to which rents could be raised.
    - **Advantages to housing providers:** Housing providers would continue to enjoy the benefits of the existing RSO provisions, and would potentially be able to charge up to the higher dollar amount in years when there might be a relatively low change in CPI.
    - **Disadvantages to housing providers:** In years when there is a high percent change in CPI, rent increases would be capped at the maximum dollar amount, inhibiting the ability for housing providers to benefit from the full increase in CPI, and also potentially narrowing the margin between operating revenues and expenses if most expenses continue to grow with CPI, and therefore may not cover operating costs.
    - **Advantages to tenants:** Tenants who might have otherwise experienced a rent increase due to a high change in CPI would benefit from a lower maximum allowable dollar amount increase, and it would potentially help reduce disparity in the increase in rents between tenants with comparatively high and low rents.
    - **Disadvantages to tenants:** Assuming housing providers seek to maximize rent increases, lower-rent paying tenants may be hit with a comparatively higher nominal rent increase than higher-paying tenants. Chapter 6 Tenants also would not receive the benefit of years when the CPI change is below 3.0 percent, as this is an allowable minimum rent increase that Chapter 6 housing providers may seek.

Administrative Considerations: This would necessitate a minimal amount of additional staff time to draft and support adoption of the RSO changes, and track rent increases and ensure that they comply with either the maximum dollar amount or change in CPI.

3. **Set a fixed annual maximum allowable rent percentage increase for Chapter 6 Tenants:** In this case, the City would establish a fixed maximum percentage up to which rents could be increased in any given year, and eliminate the minimum 3.0 percent increase and continue to use the CPI for Chapter 6 Tenants. The maximum allowable rent increases for Chapter 5 would remain the same.

- **Advantages to housing providers:** Depending on how high the fixed percentage is set, it could potentially allow housing providers with flexibility to achieve close to market-rate rents during strong economic periods, and would also provide some regulatory certainty that they could at least seek a given rent increase amount in future years.
- **Disadvantages to housing providers:** A low fixed percentage maximum might result in missed revenue-earning opportunities for housing providers during strong economic periods, while operating expenses may continue to increase.
- **Advantages to tenants:** A fixed maximum percentage would provide certainty that rent increases could not exceed a specified amount.
- **Disadvantages to tenants:** A relatively high fixed maximum percentage risks having the effect of limiting only the most extreme rent increases, and could potentially subject tenants to essentially market rate rent increases that they might have otherwise faced when seeking housing elsewhere. And, existing Chapter 6 pass-throughs would remain in place.

Administrative Considerations: This option would require a modest cost to draft and support enactment of the RSO changes, but would not result in any significant additional cost for staff time or other resources.

4. **Eliminate allowable maximum and minimum rent increases and set increases entirely on 100 percent or some fraction of percentage change in CPI:** In this case, the City would allow rent increases to fluctuate with changes in the CPI.
    - **Advantages to housing providers:** Housing providers could theoretically cover their operating costs if they rise commensurately with inflation, and they would enjoy high rent increases during strong markets.
    - **Disadvantages to housing providers:** Low percentage changes in the CPI for the Los Angeles area might not reflect an otherwise strong Beverly Hills housing market, meaning that housing providers would not be able to fully realize market opportunities.
    - **Advantages to tenants:** Given the average annual change in CPI of 2.4 percent between 2001 to 2017, tenants would likely be subject to fairly low increases over time.
    - **Disadvantages to tenants:** Fluctuations in CPI may be unpredictable, and could result in certain years that allow for high and unanticipated rent increases. And, existing Chapter 5 and Chapter 6 pass-throughs would remain in place.

Administrative Considerations: This option would require a modest cost to draft and support enactment of the RSO changes, but would not result in any significant additional cost for staff time or other resources.

5. **Allow more operating expense passthroughs for Chapter 6 housing providers without an application process:** In this case, the City would expand opportunities for Chapter 6 housing providers to pass through certain expenses like utility expense surcharges, capital expenditures, improvements mandated by law, property taxes, voter indebtedness, or others to tenants in the form of increased rents, with or without limits to what share of the respected expense may be passed through.
    - **Advantages to housing providers:** Housing providers would be able to leverage their operating expenses to increase rents, potentially beyond allowable percentage increase

levels. Creating consistency between Chapter 5 and Chapter 6 passthrough provisions would also provide a benefit to housing providers who have buildings with both Chapter 5 and Chapter 6 Tenants.

- **Disadvantages to housing providers:** Little to no disadvantage, other than potentially creating time-consuming processes to pass through expenses and fostering tension between housing providers and tenants.
- **Advantages to tenants:** Little to no advantages.
- **Disadvantages to tenants:** Tenants would be subject to higher rents than what the allowable increase might be.

Administrative Considerations: This option would require a modest cost to draft and support enactment of the RSO changes. More allowable pass-throughs would likely reduce the frequency of rent increase applications, resulting in a cost savings; however, cost savings would likely be offset by the additional staff time required to monitor pass-throughs.

6. **Limit operating expense pass-throughs, either by precluding them or by requiring formal rent increase application processes:** In this case, the City would reduce or eliminate allowable expense pass-throughs, or approve certain pass-throughs only through a petition process.
    - **Advantages to housing providers:** Little to no advantage.
    - **Disadvantages to housing providers:** Housing providers would have fewer opportunities to cover unexpected expenses, and would likely need to undergo a potentially time-consuming rent increase application process.
    - **Advantages to tenants:** Tenants would not face unexpected rent increases due to rises in expenses for pass-through expenses.
    - **Disadvantages to tenants:** Tenants may still be subject to rent increases resulting from successful rent increase application processes.

Administrative Considerations: This option would require more modest cost to draft and support enactment of the RSO changes. Reducing the categories of allowable pass-throughs would likely increase the frequency of rent increase applications, thereby creating potentially significant additional costs for staff time and other resources, although some of these costs could be offset by application fees.

7. **Require apartment buildings to meet habitability standards in order for housing providers to increase rents:** In this case, the City would establish new habitability standards that all RSO apartments must meet to permit respective housing providers to increase rents.
    - **Advantages to housing providers:** Little to no advantage, other than promoting property upkeep which would generally support property value and attractiveness to tenants.
    - **Disadvantages to housing providers:** Housing providers would potentially face costly improvements to their properties, and may be unable to afford improvements if they cannot commensurately increase rents.
    - **Advantages to tenants:** Tenants would enjoy both assured apartment quality standards, and be protected from rent increases if these standards are not met.
    - **Disadvantages to tenants:** Little to no disadvantage, other than potentially facing rent increases if housing providers are permitted to pass through the cost of improvements necessary to meet habitability standards.

Administrative Considerations: This option would require more significant cost to research, draft and support enactment of the RSO changes. It would also require substantial additional staff time and other resources to monitor and enforce property habitability standards, and associated rent increases, although some of these costs could be offset by inspection and application fees.

Attachment A
San Jose ARO Study Excerpt on the Standard of Fair Return

Study of the Apartment Rent Ordinance of the City of San José

Final Report

April 2016

Kenneth Baar

Patrick Burns

Daniel Flaming

Underwritten by the City of San José, California

Chapter 5

Individual Rent Adjustment Standards under the ARO and Constitutional Standards For Fair Return

Introduction

The purposes of this chapter are to discuss the standards under the ARO for authorizing rent increases in excess of the annual allowable across-the-board increases and to discuss constitutional fair return requirements.

A central purpose of individual rent adjustment standards under rent stabilization ordinances is to insure that apartment owners may obtain a fair return in cases in which the annual allowable rent increases are not adequate to provide a fair return. Under the type of fair return standard that is mostly widely used under rent stabilization ordinances, apartment owners have a right to rent increases which are adequate to cover increases in operating costs and provide for growth in net operating income. Questions that emerge include: how the individual rent adjustment standards in the ARO compare with constitutional fair standards, and the current and potential future impacts of the current standards.

Under the ARO, if a tenant objects to a rent increase in excess of the allowable annual increase, the apartment owner must justify the additional rent increase through the administrative hearing process on the basis of the individual rent adjustment standards. Under the current individual rent adjustment standards in the ARO, which are a type of fair return standard, owners may pass through increases in operating costs and debt service payments since the prior year to the extent these increases are not covered by the allowable annual increases and vacancy decontrols.

In order to consider issues related to the individual rent adjustment standard, it is essential to provide an explanation of:

1) fair return concepts from a constitutional, economic, and regulatory perspective,
2) the types of fair return standards used among jurisdictions with rent stabilization ordinances,
3) the rationale related to the use of different types of fair return standards , and the advantages and drawbacks in the context of rent regulation, and
4) what options the City has in regard to fair return standards and other standards.

The explanation is detailed because fair return concepts are multifaceted and in some ways operate in a manner that may be counterintuitive.

A. Constitutional Standards for Fair Return – Judicial Doctrine

Owners of rent regulated properties have a constitutional right to a "fair return." Under all rent stabilization ordinances, including the ARO, regulated owners may petition for a rent increase above the amounts authorized by the annual adjustment standard in order to present a claim that an additional increase is necessary to obtain a fair return. Cities may select the fair return formulas that apply to fair return petitions. However, the courts are the ultimate arbiter's of whether a fair return has been permitted.

In fact, very few fair return petitions have been filed under California's apartment rent control ordinances as long as vacancy decontrols have been in effect. This outcome has occurred because the combination of annual rent increase allowances and vacancy decontrols have allowed overall rent levels to increase by more than the CPI and therefore have been adequate to cover operating cost increases and to permit growth in net operating income.

1. General Guidance in Judicial Precedent

When peacetime rent stabilization ordinances were first introduced in California, towards the end of the 1970's and early 1980's, there was conflicting authority and substantial uncertainty about which fair return standard would meet judicial approval. In the face of this uncertainty, cities adopted rent stabilization ordinances that usually contained very general guidelines or statements of principle without setting forth a specific definition of fair return or a methodology for determining what constitutes a fair return. (Typically, these general provisions were supplemented with more specific regulations.)[1]

In 1983, in response to a legal challenge based on a claim that the fair return provisions in a rent control ordinance were overly vague, the California Supreme Court held that an ordinance does not have to contain a specific fair return formula and that the selection of a formula is a legislative task. The Court stated:

> That the ordinance does not articulate a formula for determining just what constitutes a just and reasonable return does not make it unconstitutional. Rent control agencies are not obliged by either the state or federal Constitution to fix rents by application of any particular method or formula. As the United States Supreme Court has stated, "[t]he Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas." [cites omitted] … The method of regulating prices is immaterial so long as the result achieved is constitutionally acceptable. (cite omitted) ["it is the result reached not the method employed which is controlling"].)[2]

In 1997, the Court reiterated longstanding general principles for fair return that have been set forth in utility cases and rent control fair return cases, stating that fair return:

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[1] See e.g. Los Angeles Rent Adjustment Commission Guidelines, Sec 240.00 ("Guidelines to be Used by Hearing Officers for Determining A Just and Reasonable Return"); San Francisco Residential Rent and Arbitration Board, Rules and Regulations, Part VI ("Rent Increase Justifications")

[2] *Carson Mobilehome Park Owners' Assn. v. City of Carson,* 35 Cal.3d 184, 191 (1983)

> 1. "involves a balancing of the investor and consumer interests," 2.should be a "return ... commensurate with returns on investments in other enterprises having corresponding risks.", and 3. "should be sufficient ... to attract capital."[3]

In 2001, the Court held in *Galland v. Clovis* that the concept of "fair rate of return" is a legal term that refers to a "**constitutional minimum**", although the terminology is borrowed from finance and economics. The Court also stated that the return must "allow [the] Owner to continue to operate successfully."[4] (While *Galland* involved mobilehome park rent regulations, the Courts have applied the same fair return principles to apartment and mobilehome park rent stabilization.). In its opinion, the Court stated:

> Although the term "fair rate of return" borrows from the terminology of economics and finance, it is as used in this context a legal, constitutional term. It refers to a constitutional minimum within a broad zone of reasonableness. As explained above, within this broad zone, the rate regulator is balancing the interests of investors, i.e., landlords, with the interests of consumers, i.e. mobilehome owners, in order to achieve a rent level that will on the one hand maintain the affordability of the mobilehome park and on the other hand allow the landlord to continue to operate successfully. [cite omitted]. For those price-regulated investments that fall above the constitutional minimum, but are nonetheless disappointing to investor expectations, the solution is not constitutional litigation but, as with nonregulated investments, the liquidation of the investments and the transfer of capital to more lucrative enterprises.[5]

While these concepts give localities and reviewing courts' broad discretion in formulating fair return standards, they leave uncertainty as to what outcomes would be considered reasonable and constitutional by the courts when reviewing "as applied" challenges to administrative rulings on individual petitions by Rent Boards or hearing officers. ("As applied" challenges are challenges to individual decisions, as opposed to "facial" challenges which involve a challenge to the overall validity of the law or regulations.)

Uncertainty as to what constitutes a fair return has been augmented by the fact that over a forty-year span appellate courts have reached diametrically opposite conclusions in regard to particular fair return issues. Furthermore, debate over the issue has been complicated by the fact that individual passages in court opinions, when taken out of context, can lend support to propositions at variance with the overall conclusions in those opinions.

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[3] *Kavanau v. Santa Monica Rent Control Board*, 16 Cal.4th 761, 772 (1997).

[4] As explained in the following portions of this chapter, the right to "operate successfully" has not included the right to cover mortgage indebtedness.

[5] 24 Cal.4th 1004, 1026 (2001)

2. Specific Guidance on Fair Return in Judicial Precedent

In 1984, in *Fisher v. City of Berkeley*, the State Supreme Court set forth some specific principles in in a lengthy discussion of fair return issues.[6]

a. Rejection of Claims to a Right to a Fair Return on "Value"

The Court held that a standard which defines a fair return as a fair rate of return on the ***value*** of a regulated property is "circular" in the context of regulation. Such a standard is circular because value depends on the allowable rent and, therefore, cannot be used to determine what rent should be allowed to permit a fair return.

The Court explained:

> The fatal flaw in the return on value standard is that income property most commonly is valued through capitalization of its income. Thus, the process of making individual rent adjustments on the basis of a return on value standard is meaningless because it is inevitably circular: value is determined by rental income, the amount of which is in turn set according to value. Use of a return on value standard would thoroughly undermine rent control, since the use of uncontrolled income potential to determine value would result in the same rents as those which would be charged in the absence of regulation. Value (and hence rents) would increase in a never-ending spiral. [7]

It also held that a rent regulation is not invalid just because it reduces the value of properties and that: "Any price-setting regulation, like most other police power regulations of property rights, has the inevitable effect of reducing the value of regulated properties."[8]

3. The Right to an Increasing Net Operating Income

In *Fisher*, the Court also gave other guidance that has come to play a central role in fair return doctrine. The Court held that a regulatory scheme "may not indefinitely freeze the dollar amount …profits without eventually causing confiscatory results. …If the net operating profit of a landlord continues to be the identical number of dollars, there is in time a real diminution to the landlord which eventually becomes confiscatory." [9] In other words, growth in net operating income must be permitted. This concept is critical because it sets forth a standard for fair return – whether or not allowable rent increases have been adequate to cover increases in operating costs and permit growth in net operating income.

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[6] *Fisher v City of Berkeley*, 37 Cal.3d. 644, 679-686 (1984).

[7]. *Id*. 37 Cal.3d.at 680, fn 33.

[8] *Id*., 37 Cal.3d. at 686.

[9] *Id*. 37.Cal.3d. at 683.

B. The Maintenance of Net Operating Income (MNOI) Standard

The type of fair return standard which is used to determine whether allowable rent increases have been adequate to cover operating cost increases and permit growth in net operating income, by comparing current current net operating income with a base year net operating income is known as a "maintenance of net operating income" (MNOI) standard.

Under this standard – known as a "*maintenance of net operating income" (MNOI)* standard – apartment owners are entitled to rent increases which are adequate to cover operating cost increases and to permit growth in net operating income. (In the context of fair return, "maintenance" of net operating income includes the concept of maintaining the value of the net operating income by providing for an inflation adjustment factor in calculating fair net operating income. Net operating income is income net of operating expenses; debt service is not considered as an operating expense.)[10]

Under MNOI standards, "fair return" (fair net operating income) is calculated by adjusting base year net operating income by a portion of or by one hundred percent of the percentage increase in the Consumer Price Index (CPI) since the base year. For example, under a standard which provides for indexing the net operating income at 100% of the rate of increase in the CPI, if the net operating income was $100,000 in the base year and the CPI has increased by 70% since the base year, the current fair net operating income would be $170,000.

Under most MNOI standards, the year specified as the base year precedes the adoption of rent regulation. However, a more recent year may be used as the base year. Jurisdictions with MNOI standards provide for indexing a base period of net operating income by varying percentages of the percentage increase in the Consumer Price Index, ranging from 40% to 100%. Berkeley and Santa Monica provide for 40% indexing and most mobilehome ordinances index by less than 100%. All of these indexing standards have been upheld by the Courts.[11]

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[10] "Net operating income" may be contrasted with "net income" which is income net of debt service payments.

[11] See *Berger v. City of Escondido*, 127 Cal.App.4th 1, 13-15 (2007); *Stardust v.City of Ventura*, 147 Cal.App. 4th 1170, 1181-1182 (2007); *Colony Cove Properties v. City of Carson*, 220 Cal. App.4th 840, 876 (2013)

The rationale for less than 100% indexing has been that the rate of increase in equity may exceed 100% of the rate of increase in the CPI even if the rate of increase in the overall value of a property is lower. For example, the value of an apartment building may increase by 20% from $1,000,000 to $1,200,000, but the increase in the equity of an owner who purchased with a 70% loan may increase from $300,000 to $500,000.

In the Colony Cove opinion, the Court stated:

> In *H.N. & Frances C. Berger Foundation v. City of Escondido*, the court explained why 100 percent indexing was not required for a rent controlled mobilehome park to achieve a fair return: "A mobilehome park's operating expenses do not necessarily increase from year to year at the rate of inflation, and . . . a 'general increase at 100% of CPI . . . would be too much if expenses have increased at a lower rate.'" (*H.N. & Frances C. Berger Foundation v. City of Escondido [cite omitted]*.) Moreover, "the use of indexing ratios may satisfy the fair return

(cont.)

The example below illustrates how MNOI standards work. In the hypothetical, rents have increased by $50,000 between the base year and the current year. During this period operating costs have increased by $30,000 and the net operating income has increased by $20,000, from $60,000 in the base year to $80,000 in the current year. Through an individual rent adjustment petition (with adequate documentation of income and operating expenses) the owner would be able to obtain an additional rent increase The allowable increase would be $10,000 because the fair net operating income (the base year net operating income adjusted by the CPI increase) is $90,000.

Table 5.1
Illustration of MNOI Standard

	CPI	Gross Income	Operating Expenses	Net Operating Income	Fair Return Allowable Rent Increase
Base Year *	**100**	**$100,000**	**$40,000**	**$60,000**	
Current Year	**150**	**$150,000**	**$70,000**	**$80,000**	
Current Year Fair Net Operating Income (Base Year NOI Adjusted by 50% increase in CPI)				**$90,000**	
Fair NOI – Current NOI *($90,000 – $80,000)*					**$10,000**

The MNOI has been adopted by Los Angeles, Santa Monica, Berkeley, West Hollywood, East Palo Alto and is in effect under San Jose's mobilehome park rent stabilization ordinance.[12] In addition, this type of standard is set forth in a substantial portion of the mobilehome park rent stabilization ordinances in the State and is often applied under other mobilehome rent stabilization ordinances, which list factors to be considered in determining what is a fair return, without setting forth a formula. (Approximately ninety jurisdictions regulate mobilehome park rents.)

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criterion because park owners typically derive a return on their investment not only from income the park produces, but also from an increase in the property's value or equity over time." (*Ibid*.; accord *[cite omitted]* [explaining that "one reason for indexing NOI at less than 100 percent of the change in the CPI" is that "real estate is often a leveraged investment" in which "[t]he investor invests a small amount of cash, but gets appreciation on 100 percent of the value"]. *Id*.876-877.

[12] San Jose Muni Code Sec. 17.22.470-580.

Rationale for the MNOI Standard

The MNOI standard works differently than rate of return standards because it compares the net operating income with a prior (base year) net operating income rather than comparing the net operating income with the investment (purchase price). It is not an "intuitive" measure because it is not a real estate return measure that is commonly used by investors or laypersons, but rather is a measure of fair return under rent regulation. The rationale for the use of this type of standard is set forth in the following discussion.

By providing for growth in net operating income, the MNOI standard provides for growth in the portion of rental income (the net operating income) that is available to pay for increases in debt service, to fund capital improvements, and/or to provide additional cash flow (net income). Therefore, the growth in net operating income also provides for appreciation in the value of a property. The standard provides all owners with the right to an equal rate of growth in NOI regardless of their particular purchase and financing arrangements. By measuring reasonable growth in net operating income by the rate of increase in the CPI, this approach meets the twin objectives of "protecting" tenants from rent increases that are not justified by operating cost increases and increases in the CPI, and of providing regulated owners with a "fair return on investment."

Under the MNOI standard, it becomes the investor's task to determine what investment and financing arrangements make sense in light of the growth in net operating income permitted under the fair return standard.

In fair return challenges, appellate courts have repeatedly upheld the use of an MNOI standard.[13] In 1984, a Court of Appeal found that the MNOI standard was reasonable because it allowed an owner to maintain prior levels of profit. [14] In 1998, a Court of Appeal concluded that the MNOI formula is a "fairly constructed formula" which provides a ""just and reasonable" return on ... investment," even if an alternative fair return standard – such as the rate of return on investment standard (discussed further below) – would provide for a higher rent.

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[13] Most of the published appellate court opinions regarding fair return under rent regulation have involved mobilehome park rent regulations. This is a consequence of the facts that: 1) the mobilehome rent regulations are stricter – not allowing for increases upon vacancies, 2) some of the mobilehome rent ordinances have not allowed for annual across-the-board rent increases, thereby compelling owners to submit fair return petitions each time they desire to obtain a rent increase, 3) the stakes in mobilehome park cases are substantial due to the size of mobilehome parks, typically involving from one to several hundred spaces. However, in regards to fair return issues the fair return concepts are interchangeable with the courts relying on fair return opinions from apartment cases in mobilehome park cases and vice versa.

[14] *Oceanside Mobilehome Park Owners' Ass'n v. City Oceanside,* 157 Cal.App.3d.887 (1984); Also see *Baker v. City of Santa Monica,* 181 Cal.App.3d. 972 (1986)

> [the] MNOI approach adopted by the Board is a "fairly constructed formula" which provided Rainbow a sufficiently "just and reasonable" return on its investment. ... The Board was not obliged to reject [an] MNOI analysis just because an historical cost/book value formula using Rainbow's actual cost of acquisition and a 10 percent rate of return would have yielded a higher rent increase.[15]

Typically, the base year under an MNOI standard precedes the adoption of rent control based on the concept that rent levels which were set in the unregulated market provided a fair return. In the case of San Jose, the allowable annual increases, which have substantially exceeded the rate of increase in the CPI, clearly have been sufficient to allow owners to preserve pre-regulation levels (inflation adjusted) of net operating income.(See discussion in Chapter 6) In instances in which an MNOI standard is adopted years after the initial adoption of rent control, owners will not have not have records from earlier decades and will not have been on notice that such records would ever be relevant in a fair rent determination. Therefore, a recent year could be used as the base year. Owners should have income and expense records for the last three years, since under federal tax law, businesses are required to retain their business records for three years.

C. Rate of Return on Investment Standards

In *Fisher*, Court indicated that a return on investment standard could provide a fair return. However, its qualifications about such standards illustrated the difficulties with such an approach.

Rent ordinances commonly include a provision stating that their purpose is to provide a fair "return on investment." However, **none of the California jurisdictions with apartment rent regulations have used a "'*rate'* of return on investment" standard**. This type of standard has been implemented under some mobilehome park space rent ordinances.

When rate of return on investment formulas have been used in the context of rent regulations, the most common formula has been:

[15] *Rainbow Disposal v. Mobilehome Park Rental Review Board*, 64 Cal. App.4th 1159, 1172 (1998)

FAIR RENT = OPERATING EXPENSES + X% of INVESTMENT

The allowable rent depends on what rate of return is considered fair. The following examples illustrate the outcomes under a 6% and a 9% rate of return standard.

FAIR RENT = OPERATING EXPENSES + X% of INVESTMENT

		(fair net operating income)
$70,000	+	**6%** of $1,200,000
$70,000	+	$72,000
		= $142,000
	or	
$70,000	+	**9%** of $1,200,000
$70,000	+	$108,000
		= $178,000

Investment is defined as the total investment (purchase price + improvements) rather than only as the cash investment (total investment minus mortgage borrowing). The return is the net operating income (income before mortgage payments), rather than only the cash flow (net operating income left after mortgage payments).[16] In other words, the total return is compared with the total investment.

Circularity of the *Rate* of Return on Investment Standard

Rate of return on investment is commonly used as a measure of return by real estate analysts in evaluating real estate investments. Intuitively, the concept that investors should always be permitted a fair rate of return on their investments is commonly accepted . However, in the context of a fair return determination under a rent regulation, the use of a fair rate of return on investment standard works in a **circular** manner.

In the market place, investment is determined by the expected returns. If the allowable returns under a price regulation are set at designated percentage of the investment, the process of determining what is a fair return becomes circular. Under such an approach, h the investment (and, therefore, the investor) determines what return and, therefore, what rents will be fair.

[16] In some jurisdictions a fair return on cash investment standard has been used. However, such standards discriminate among owners based on their financing arrangements. In three cases, a California Court of Appeal has ruled that consideration of debt service in a rent setting standard has no rational basis. *Palomar Mobilehome Park Ass'n v. Mobile Home Rent Review Commission* [San Marcos], 16 Cal.App.4th 481, 488 (1993) and *Westwinds Mobilehome Park v. Mobilehome Park Rental Review Board* [Escondido], 30 Cal.App.4th 84, 94 (1994), *Colony Cove v. City of Carson*, 220 Cal.App.4th 840, 871 (2013).

A leading utility text notes the fallacies and circularity of using the purchase price (the "transfer cost") as the measure of investment in order to calculate fair return, in the context of a price regulation.

> Transfer cost does not represent a contribution of capital to public service. Instead, it represents a mere purchase by the present company of whatever legal interests in the properties were possessed by the vendor. Even under an original-cost standard of rate control, investors are not compensated for buying utility enterprises from their previous owners any more than they are compensated for the prices at which they may have bought public utility securities on the stock market. Instead, they are compensated for devoting capital to public service. ...
> The unfairness, not to say the absurdity, of a uniform rule permitting a transferee of a utility plant to claim his purchase price was noted by Judge Learned Hand … The builder who does not sell is confined for his base to his original cost; he who sells can assure the buyer that he may use as a base whatever he pays in good faith. If the builder can persuade the buyer to pay more than the original cost the difference becomes part of the base and the public must pay rates computed upon the excess. Surely this is a most undesirable distinction. (Niagara Falls Power Company v. Federal Power Commission, 1943 ...)[17]

This fallacy has been generally overlooked in rent control cases. However, federal courts in New York have concluded that the return on investment approach does not make sense in the context of land use controls and rent regulation. They have noted that under the rate of return on investment approach, the "regulated" investor is able to regulate the allowable return by determining the size of the investment. In a zoning case, the Court held:

> In addition to being inconsistent with the case law, appellants' [return on investment] approach could lead to unfair results. For example, a focus on reasonable return would distinguish between property owners on the amount of their investments in similar properties (assuming an equal restriction upon the properties under the regulations) favoring those who paid more over those who paid less for their investments. Moreover in certain circumstances, appellants theory "would merely encourage property owners to transfer their property each time its value rose, in order to secure ... that appreciation which could otherwise be taken by the government without compensation..." [cites omitted][18]

While the California courts have upheld the use of a rate of return on investment standard, they have noted the limitations of such an approach. In the *Fisher* case, the California Supreme Court noted that the "mechanical" application of a return on investment standard could produce

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[17] Bonbright, Danielson, and Kamerschen, Principles of Public Utility Rates, 240-241 (1988, Arlington, Virginia, Public Utilities Reports, Inc.)

[18] *Park Avenue Tower Associates v. City of New York*, 746 F.2d. 135, 140 (1984).

"confiscatory results in some ....cases" and alternatively could provide for "windfall" returns of recent investors, who paid high prices:

> At the same time that mechanical application of the fair return on investment standard may have the potential to produce confiscatory results in some individual cases [cites omitted] it is also recognized that the standard has the potential for awarding windfall returns to recent investors whose purchase prices and interest rates are high. If the latter aspect were unregulated, use of the investment standard might defeat the purpose of rent price regulation.[19]

On the other hand, if a "prudent" investor standard is used to try to curb abuses of a rate of return on investment standard by limiting what size investments will be considered in measuring what net operating income would be fair, the results also become circular. Under this type of approach the investment may be considered "prudent" only if the current rents are already adequate to generate a net operating income which is adequate to generate the rate of return which is considered reasonable. If this approach is followed no rental increase can ever be justified by the standard.

Subsequent to the *Fisher* opinion, one Court of Appeal concluded that the argument that a purchase cost may be viewed as high (imprudent) is a "Catch-22.". The Court explained:

> ... it is a "Catch-22" argument. It posits that a prudent investor will purchase only rent-controlled property for a price which provides a fair rate of return at the then-current (i.e. frozen) rental rates. Having done so, however, the fair market value is frozen ad infinitum because no one should pay more than the frozen rental rate permits; and existing rental rates are likewise frozen, since the investor is already realizing a "fair rate of return".[20]

This duality in concepts in regards to rate of return on investment standards is not an accident. It reflects the inevitable appearance of the two sides of a circular concept. On the one hand, there is the view that rate of return on investment standards should not provide windfall returns to recent investors and should not provide an incentive to invest as much as possible for a property by providing a right to charge rents that will provide a fair return on any investment. On the other hand, there is the view that an owner should be able to obtain a fair return on a prudent investment. However, if such an approach is adopted, an investment may be considered imprudent if the current rents do not yield a fair return on that investment.

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[19] 37 Cal.3d. 644, 691 (1984)

[20] *Westwinds Mobile Home Park v. City of Escondido*, (1994), 30 Cal.App.4th. 84, 93-94.

Subjectivity and Differences in How to Measure Fair Rate of Return under a Rate of Return on Investment Standard

Apart from the circularity issues associated with the use of a rate of return on investment standard, there are substantial issues associated with the calculation of the investment (the rate base) and with the determination of an appropriate rate.

In fact, rates of return vary substantially among properties, especially in times of substantial inflation in property values. Therefore, the net operating income (and, consequently the rent) that will yield a fair return on an investment made decades ago might be a fraction of the rent required to provide the same rate of return on the investment of a recent purchaser.

When rate of return on investment standards are used, a host of options appear for measuring the investment and for the determination of a reasonable rate of return. In an adjudicatory process the fair return determination can turn into a mix and match process (among the alternate measures of investment and of a fair rate) aimed at obtaining a desired result.

Selecting a Rate

The selection of an appropriate rate presents one set of problems. Varying theories and/or statistical constructions" about how to compute what is a "fair rate" can lead to widely differing outcomes. One commentary, in a textbook on utility rate regulation, characterizes expert presentations on which particular rate is as "witches brews of statistical elaboration and manipulation".

> "... as we begin sheer disgust to move away from the debacle of valuation, we will probably substitute a new form of Roman holiday— long-drawn-out, costly, confusing, expert contrived presentations, in which the simple directions of the *Hope* and *Bluefield* cases are turned into veritable witches' brews of statistical elaboration and manipulation.[21]

In mobilehome park rent stabilization fair return cases, expert witness' projections of a fair rate of return have ranged from 4% to 12% (and even higher). Typically, in recent years, experts on behalf of mobilehome park owners have testified that a rate of return of about 9% is fair, while experts on behalf of cities and/or residents have contended that a fair rate is equal to the prevailing capitalization rate, now about 5 to 6%.[22] Adjudicators' (retired judges acting as

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[21] Shepard and Gies, *Utility Regulation, New Directions in Theory and Policy*, 242-243 (1966, New York, Random House)

[22] The prevailing capitalization rate is the net operating income/purchase price rate that new purchasers are obtaining at the outset of their investments. When the purchase price is inflation adjusted in the fair return analysis the fair return also becomes inflation adjusted.

arbitrators, rent commissions, trial courts, and appellate courts) conclusions about what rate is fair have ranged from 5% to 9%.

Measuring the Investment (The Rate Base)

The selection of a rate base raises another set of issues. Large variations in the outcome of a fair return calculation can also be generated by alternate choices in regard to the measure of the investment (rate base). One principal issue within the return on investment debate has been over whether the original investment should be used as a rate base or whether that investment costs should be adjusted for inflation. Typically, long-term owners have investments that are low by current standards, while recent purchase prices have low rates of return relative to their investment. The problem with the return on investment approach is that in periods of inflation in the prices of real property, the fair return becomes a function of the length of ownership. As a result, the rate of return on investments in apartment buildings with comparable rents and operating costs will vary substantially based on the purchase date of the building.

Some courts have held that the investment should be inflation adjusted to reflect the real amount of the investment in current dollars. In *Cotati Alliance for Better Housing v. City of Cotati*, a California Court of Appeal concluded that Cotati's return on investment standard was not confiscatory because "[t]he landlord who purchased property years ago with pre-inflation dollars is not limited to a return on the actual dollars invested; the Board may equate the original investment with current dollar values and assure a fair return accordingly."[23] Commonly, if not usually, when rate of return on investment standards are used, the rent setting body has adjusted the original investment by inflation.

However, in other instances California appellate courts have upheld the use of a formula under which investment was calculated in a manner virtually opposite to adjusting the original investment by inflation. Instead they have upheld "…taking the price paid for the property and deducting accumulated depreciation to arrive at a net historic value" See e.g. *Palomar Mobilehome Park Assn. v. Mobile Home Rent Review Com*. (1993), 16 Cal.App.4th 481, 487, in which the Court reasoned:

> [The park owner] argues that "historic cost" approach effectively transfers to tenants the use of $11 million in assets (the difference between the historic cost of the property and its current value) free of charge. It is true that in calculating a "fair" return, the City's proffered formula does not give park owners credit for any appreciation in the value of their property. Yet this is true any time a "fair return on investment" approach is used in lieu of a "fair return on value" formula. As we have explained .... both the United States and California Supreme Courts have approved the "investment" approach as constitutionally permissible. We are in no

[23] 148 Cal.App.3d. 280, 289 (1983)

> position to hold to the contrary by accepting Palomar's value-based test as a constitutional minimum. (Id. 16 Cal.App. 4th at 488)

The table on the following page illustrates how the wide range of possible rate bases and fair rates possible can lead to vastly diverging results under a rate of return on investment formula.

Table 5.2

Alternate Outcomes under Rate of Return on Investment Standard (Investment x Fair Rate = Fair Net Operating Income)

Investment (Rate Base)	Fair Rate	Fair Net Operating Income* (fair rate x investment)
$2,000,000 original investment (e.g. 40 apartments x $50,000 / apartment unit)	**5%** capitalization rate (prevailing noi/purchase price ratio purchases in 2015)	**$100,000**
	7%	**$140,000**
	9%	**$180,000**
$1,200,000 original investment minus depreciation of improvements	**5%**	**$60,000**
	7%	**$84,000**
	9%	**$108,000**
$4,000,000 original investment adjusted by CPI	**5%**	**$200,000**
	7%	**$280,000**
	9%	**$360,000**

* Allowable rent = fair net operating income + operating expenses

Even if the original investment is inflation adjusted, the outcome under a rate of return on investment standard is heavily dependent on whether an apartment owner purchased a property in a low or high cycle in real estate values. The hypothetical below illustrates how the standard may work. An owner who paid the same price for a property in 2010 (at the end of flat cycle in apartment values) as an owner paid in 2000 (at the end of a surge in values) is permitted a much lower rent under this type of standard, because the period of inflation used to adjust the purchase price is much shorter.

Outcomes Under Rate of Return on Investment Formula
Using Inflation Adjusted Investment

Purchase Year	1990	2000	2010	2015
Average Purchase Price/Unit	59,000	107,000	106,000	191,000
Base Year CPI	132.1	180.2	227.469	258.572
Current CPI	258.572	258.572	258.572	258.572
Inflation (CPI) Adjustment of Original Purchase Price	96%	43%	14%	0%
Purchase Price /Unit CPI Adjusted	115,486	153,536	120,494	191,000
7% of Purchase Price	8,084	10,748	8,435	13,370
Annual Operating Expenses/ Unit	5,400	5,400	5,400	5,400
Allowable Annual Rent (7% of purchase price + operating expenses)	13,484	16,148	13,835	18,770
Allowable Monthly Rent	1,124	1,346	1,153	1,564

Furthermore, under a rate of return on investment standard, the amount of rent that is required to provide a fair return can actually decrease as a result of a downward cycle in values (and, therefore, investments.).

D. San José's Fair Return Standard

San Jose, Oakland and San Francisco have used a different standard than either the MNOI standard or the rate of return on investment standard in the formulation of their fair return standards. Under the standards of these jurisdictions, apartment owners are allowed to pass through increases in operating costs over the prior year to tenants. In San Jose, when a pass-through is being considered in an individual rent adjustment hearing, the allowable rent increase over the prior year's rent is set at an amount adequate to cover the allowable cost increases (for operations and maintenance, rehabilitation, and/or capital improvements) over the prior year plus 5%. As a result, this formula allows the for the possibility of obtaining a rent increase in excess of the annual allowable increase of 8%. These pass-through standards, including San Jose's

standard, do not provide for any consideration of what rent increases have occurred before the prior year and how those rent increases have compared with increases in operating expenses before the prior year.

The ARO provides for pass-throughs of increases in operating expenses, rehabilitation, capital improvements, and debt service.[24] The standard includes requirements that rehabilitation costs must be amortized over at least three years and capital improvements must be amortized over at least five years.[25] Increases in debt service interest are subject to a limitation to the interest associated with mortgage amounts that do not exceed 70% of the value of the property. The regulations contain detailed rules regarding consideration of increased debt service costs.[26] The pass-through amounts for each of the four provisions become part of next year's base rent.

While the ordinance and regulations provide for specific rules regarding rent increase allowances for cost pass-throughs, the ordinance also includes subjective directions that increases must be:

> reasonable under the circumstances, taking into consideration that the purpose of this chapter is to permit landlords a fair and reasonable return on the value of their property while protecting tenants from arbitrary, capricious, or unreasonable rent increases, and under certain circumstances, unjustified economic hardship…

and that consideration shall be given to the:

> reasonable relationship to the purposes for which such costs were incurred and the value of the real property to which they are applied.

As indicated, the City's standard provides for the possibility that petitions for large rent increases may be filed by recent purchasers of apartments, in order to pass-through increases in debt service over the debt service level of the prior owner.

San Francisco and Oakland's Pass-through Provisions

San Francisco's pass-through provision is similar to the San Jose standard, but San Francisco's standard contains two prominent limitations on pass-through increases, which are not contained in the ARO. Under San Francisco's pass-through allowance, increases are limited to seven percent and may not be imposed more than once every five years.[27]

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[24] Sec. 17.23.440

[25] Sec. 17.23.440.A.3.

[26] Sec. 17.23.440.B.and Apartment Regulations Sec. 2.030.03.

[27] San Francisco Rent Stabilization & Arbitration Board, Rules and Regulations, Sec. 6.10(d).

Oakland's pass-through provisions are also similar to those of San Jose, except that Oakland eliminated the debt service pass-through for newly acquired units on April 1, 2014. (This restriction is not applicable to units on which a bona-fide offer to purchase was made before that date.[28])

E. Treatment of Debt Service Expenses under San Jose's Ordinance and Other Ordinances and Issues Associated with Allowances for Debt Service Expenses

Treatment of Purchase Related Increases in Debt Service under the San Jose ARO

Under the San Jose ARO, apartment owners may pass through purchase related increases in interest payments of debt service (mortgages) over the interest payments of the prior owner. Under the ordinance and regulations pursuant to the ordinance, an investor can pass-through to tenants up to 80% of the increases over the prior owner's debt-service costs.[29]

The absence, prior to 2014, of petitions based on increases in debt service, may be attributable to a variety of reasons, including: the high turnover in apartment tenants which enabled owners to set a substantial portion of rents at market levels; the limited portion of units which could absorb additional rent increases beyond the annual increases of 8% authorized by the ordinance; landlord decisions to forego such increases; and/or an absence of general knowledge that such increases could be imposed. The debt service petitions that were filed in 2014 resulted in substantial increases in monthly rents ranging from $64 to $481, with an average increase of $199/month. In half of the cases, the increase was greater than $250/month.

The table below sets forth the size of the buildings, the number of petitioning residents, and the rent increase granted in each case.

[28] City of Oakland, Rent Adjustment Board Regulations, Appendix A, Sec. 10.4.

[29] See Regulations Sec. 2.03.03 setting forth detailed rules regarding the treatment of mortgage interest payments. If the loan exceeds 70% of the appraised value of the property, the portion of the interest increase that can be passed through is limited to interest attributable to a 70% loan to value ratio

Table 5.3.
Debt Service Increase Petitions under ARO

Sale Date	Units	Units Served Notice of Rent Increase	Tenants Petitions Filed	Beginning Average Rent	Rent Increase Permitted (Debt-Service Pass-Through Amount)	New Average Monthly Rent	Percentage Increase
2008	8	2	2	$614	$481	$1,095	78%
2014	24	17	3	$1,120	$89	$1,209	8%
2015	8	7	6	$946	$193	$1,139	21%
2014	6	6	6	$598	$378	$976	65%
2013	12	12	11	$902	$300	$1,202	33%
2014	25	1	1	$675	$114	$789	17%
2015	7	4	1	$881	$335	$1,216	30%
2014	6	4	2	$1,298	$209	$1,507	16%
2015	6	5	1	$1,198	$327	$1,525	27%
2014	4	4	4	$1,191	$408	$1,599	34%
2015	4	4	4	$1,700	$255	$1,955	15%
2015	4	1	1	$1,920	$230	$2,150	12%
2014	6	4	1	$871	$64	$935	7%
2015	4	1	1	$2,295	$305	$2,600	17%
	124	**72**	**44**	**$1,158**	**$199**	**$1,357**	**27%**

Source: City of San Jose Housing Department, Rental Rights and Referrals Program

Assuming current volumes of apartment sales in San Jose continue, the number of instances in which there is a potential for the justification for debt service pass-through under the current standard is substantial. The records from one real estate data service includes data on the sales of 59 buildings with a total of 646 units that were sold in 2015 and 54 buildings with 1685 units that were sold in 2014. In most of those sales, the increase in price over the prior sale was $50,000/apartment unit or more and in a substantial portion cases the increase was over $100,000/apartment unit. Conservatively, assuming the increase in annual debt service is equal to 3% of the increase in the current purchase price over the prior purchase price, the additional debt service associated with a $100,000 increase in purchase would be equal to about

$300/month.[30] In cases in which the previous owner held a property for a significant length of time and paid off a portion or all of the mortgage, the difference between the new and old mortgages would be even greater.

Treatment of Purchase Related Debt Service Costs Under Other Rent Stabilization Ordinances

In contrast to San Jose's standard, six of the eleven apartment rent control ordinances specifically **exclude** consideration of debt service in setting allowable rent levels, except when the debt service is associated with capital improvements. Such exclusions exist in the ordinances of Los Angeles, Oakland, Berkeley, Santa Monica, West Hollywood, and East Palo Alto.[31] Beverly Hills ordinance does not authorize any rent adjustments for increases in debt service, but does not specifically state that debt service expenses are excluded.[32] Also, San José's Mobilehome Rent Stabilization ordinance excludes consideration of debt service costs, except when associated with the cost of capital improvements.[33]

Under the San Francisco, Los Gatos, and Hayward ordinances, increases in debt service may be passed through. However, under the San Francisco ordinance, increases based on debt service increases are limited to 7% and in buildings with six or more units are allowed only once every five years.

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[30] This projection is based on the assumption that 70% of the price, and, therefore 70% over the increase over the prior price, is financed by a mortgage and that the mortgage interest rate is 5%. Therefore, the increase in mortgage interest would be 5% of $70,000 =$3,500/year.

[31] Under Oakland regulation debt service pass-through were authorized until 2014.

[32] Beverly Hills Muni Code Sections 4-5-101 thru 4-5-707.

[33] San José Muni. Code Sec. 17.22.540.B.1. There are exceptions for refinancing required as a result of the terms of a mortgage in effect when the ordinance was adopted and for interest costs associated with the amortized costs of capital improvements.

Table 5.4
Treatment of Purchase Mortgage Interest Expenses Under Apartment Rent Stabilization Ordinances

Jurisdiction	*Consideration of Purchase Mortgage Interest Expenses*	*Limitations on Allowance of Debt Service Expenses*
Los Angeles	**Excluded**	
Oakland		Debt service pass-through repealed on April 1, 2014. Pre-repeal purchasers exempted from repeal.
Berkeley		
Santa Monica		
West Hollywood		
East Palo Alto		
Beverly Hills		
San José	**Included**	Loan to Value Ratio Limited. Standards contain a list of factors to be considered, but not a formula for how they would applied.
Hayward		
Los Gatos		
San Francisco		Increase Limited to 7% of Rent. Buildings of 6 units or more permitted only once every five years

Source: Based on author's review of rent ordinances.

Most of the MNOI standards in mobilehome park rent stabilization ordinances preclude consideration of debt service. Under the other common type of fair return standard in mobilehome park rent stabilization ordinances, rate of return on investment, consideration of debt service is also excluded because fair return is measured by the return on the total investment, rather than just the cash portion of the investment. (Consistent with using this measure of return, the rate base for measuring the return is the total investment, and the calculation of the return is based on consideration of the whole return, rather than return net of mortgage interest payments.)

Judicial Doctrine Regarding Consideration of Debt Service Interest in Setting Allowable Rent Increases

As, noted, the general judicial doctrine regarding fair return, which has been frequently reiterated in California appellate decisions, has been that: "[r]ent control agencies are not obliged by either the state or federal Constitution to fix rents by application of any particular method or

formula."[34] However, in three cases the California Court of Appeal has held that consideration of debt service in a rent setting process has no rational basis.[35]

> Assume two identical parks both purchased at the same time for $1 million each. Park A is purchased for cash; Park B is heavily financed. Under Palomar's approach, calculating return based on total historic cost and treating interest payments as typical business expenses would mean that Park A would show a considerably higher operating income than Park B. Assuming a constant rate of return, the owners of Park B would be entitled to charge higher rents than the owners of Park A. We see no reason why this should be the case.[36]

In a subsequent opinion, the same Court of Appeal reaffirmed its conclusion in regard to the treatment of debt service expenses. "We have previously rejected the notion that permissible rental rates based on a fair rate of return can vary depending solely on the fortuity of how the acquisition was financed."[37]

In a recent (2013) opinion, a California Court of Appeal again affirmed the view that tying rents to individual owners' financing arrangements has no rational basis.

> Apart from the inequities that would result from permitting a party who financed its purchase of rent-controlled property to obtain higher rents than a party who paid all cash, there are additional reasons for disregarding debt service. …debt service arrangements could easily be manipulated for the purpose of obtaining larger rent increases, by applying for an increase based on servicing a high interest loan and then refinancing at a lower interest rate or paying off the loan after the increase was granted. Alternatively, an owner might periodically tap the equity in a valuable piece of rental property, thus increasing the debt load. In any event, we discern no rational basis for tying rents to the vagaries of individual owners' financing arrangements.[38]

While the foregoing precedent holds that debt service should not be considered, in two cases around 1990, a California Court of Appeal carved out an exception to this rule. The Court held

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[34] See text at notes 3-4.

[35] *Palomar Mobilehome Park Ass'n v. Mobile Home Rent Review Commission* [of San Marcos], 16 Cal.App. 4th 481, 488 (1993);

[36] Id, at 489.

[37] *Westwinds Mobile Home Park v. Mobilehome Park Rental Review Bd*., 30 Cal.App.4th 84, 94 (1994)

[38] *Colony Cove Properties v. City of Carson*, 220 Cal.App. 840,871 (2013). Courts in other states have reached similar conclusions. In 1978, when considering the constitutionality of an apartment rent control ordinance, the New Jersey Supreme concluded that: "Similarly circumstanced landlords ... must be treated alike. Discrimination based upon the age of mortgages serves no legitimate purpose." *Helmsley v. Borough of Fort Lee*, 394 A.2d. 65, 80-81 (1978).

that mobilehome park owners have a vested right to have their debt service considered if the debt service was an allowable expense under the fair return standard in effect at the time the property was purchased.[39] In *Palacio de Anza v. Palm Springs Rent Review Commission*, the Court concluded that the guidelines in effect when the mobilehome park was purchased created vested rights.

> [the guidelines]... created land-use property rights which became vested ... when the financing of the ... purchase was undertaken in reliance on the existing rent-control laws. In this sense, [the park owner] enjoys a situation or status analogous to that of one who had established the right to pursue a nonconforming use on land following a zoning change.[40]

In a subsequent case, in 1991, the same court reaffirmed this conclusion.[41] (Prior to these cases, the City Attorney's office of San Jose reached the same conclusion.[42]) A repeal of a debt service pass-through that made an exception for units purchased prior to the repeal would conform with the holdings in these two cases.[43]

Comment

If debt service is considered, owners who make equal investments in terms of purchase price and have equal operating expenses, may be entitled to differing rents depending on differences in the size of their mortgages and/or the terms of their financing arrangements. As indicated, in three cases the California Court of Appeal has ruled that such a standard has no rational basis.

When increases in debt service can be passed through apart from other allowable rent increases, then the allowable rent is set at a level that provides "reimbursement" for the financed cost of purchasing a building. This "reimbursement" is in addition to the otherwise allowable rent increases that would provide a fair return by providing for increases in net operating income, which can be used to finance increasing debt service.

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[39] *Palacio de Anza v. Palm Springs Rent Review Com.*, 209 Cal.App.3d. 116 (1989)

[40] *Palacio*, *Id*,, 209 Cal. App.3d at 120.

[41] *El Dorado Palm Springs, Ltd.v. Rent Review Com*., 230 Cal.App.3d. 335 (1991).

[42] Memo from the Deputy City Attorney to the San José City Council, May 13, 1985 ("Limitations on Debt Service Pass Through – Retroactivity")

[43] On the other hand, it should be noted that under judicial doctrine applicable to land use law in general there has been no vested right to develop based on the fact that a land use was allowed under the zoning in effect when the purchase was made. Instead, vested rights have been limited to situations in which construction has been permitted and has commenced. Also, in a recent rent control case, a federal circuit court of appeal rejected the view that pre-rent control purchase arrangements could create a right to be free of subsequent regulations that may diminish the value of the property. *Rancho de Calistoga v. City of Calistoga*, 800 F.3rd 1083 (2015)

HR&A ADVISORS, INC.
RELOCATION REQUIREMENTS AND FEES IN THE BEVERLY HILLS RENT STABILIZATION CONTEXT

HR&A Analyze. Advise. Act.

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DRAFT MEMORANDUM

To:	Honorable Mayor and City Council, City of Beverly Hills
From:	HR&A Advisors, Inc.
Date:	July 26, 2018
Re:	Relocation Requirements and Fees in the Beverly Hills Rent Stabilization Context

The City of Beverly Hills (the "City" or "Beverly Hills") retained HR&A Advisors, Inc. ("HR&A") to provide independent research and analysis about seven policy issues related to recently enacted changes to the City's Rent Stabilization Ordinance (the "RSO").[1] This Issue Paper addresses whether, and if so how, the City Council might consider amending the RSO to adjust the circumstances under which relocation fees are due to tenants, and the relocation fee amounts.

The Issue Paper begins with a general statement about the issue, describes the City's current relocation fee regulations, summarizes positions about this issue that have been mentioned in public discussions about the RSO, and describes how this issue is addressed by 13 other California cities with rent regulation, based on a review of their ordinances and regulations and through discussions with several city representatives. Based on the information provided on this topic, the Issue Paper concludes with a set of plausible policy options for City Council, City staff, and public consideration.

Statement of the Issue

Following adoption of the RSO Amendments, the City Council and City stakeholders are evaluating the RSO requirements on relocation fees, a form of assistance for Chapter 5 and Chapter 6 Tenants facing certain evictions. The City requires housing providers to pay relocation fees for certain types of evictions in which the tenant is not culpable, including "no-cause" evictions and certain "no-fault" evictions specified by Chapter 5 and Chapter 6. These terms are defined for use in this analysis as follows:

- "No-cause" evictions are involuntary terminations of tenancies for which no reason for eviction is stated by the housing provider.[2]
- In contrast, "just-cause" evictions are involuntary terminations of tenancies for reasons established under California Code of Civil Procedure[3] or the terms of the RSO. Just-cause evictions include both "at-fault" evictions and "no-fault" evictions.

[1] Ordinance Number 17-O-2729, adopted in April of 2017 (the "RSO Amendments"). The City's Rent Stabilization Ordinance (the "RSO") regulations are included in Beverly Hills Municipal Code ("BHMC") Title 4, Chapter 5 ("Chapter 5") and Chapter 6 ("Chapter 6"). Tenants residing in RSO units subject to regulation under Chapter 5 are hereinafter referred to as "Chapter 5 Tenants;" and Tenants residing in RSO units subject to regulation under Chapter 6 are hereinafter referred to as "Chapter 6 Tenants."

[2] No-cause evictions are prohibited for Chapter 5 Tenants, and Chapter 6 generally does not address no-cause evictions in detail, other than requiring housing providers to pay relocation fees to evicted tenants and requiring housing providers to file a copy of the eviction notice with the City.

[3] Calif. Code of Civil Procedure, Sec. 1161.

- "At-fault" evictions are evictions for which the tenant is culpable and a specific reason is provided (e.g., failure to pay rent, maintenance of a nuisance, illegal uses, failure to execute lease, refusal to provide unit access, or unapproved subtenants).[4] The RSO does not require relocation fees for any type of at-fault eviction.
- "No-fault" evictions are evictions for which the tenant is not culpable and a specific reason is provided (e.g., a decision by owners to move themselves and/or an immediate family member into a given rental unit, the withdrawal of units from the rental market pursuant to the Ellis Act,[5] conversion of apartment units to condominiums, or relocation necessitated by building renovation or demolition.)[6]

Prior to the RSO Amendments, the City required relocation fees only for certain types of no-fault Chapter 5 Tenant evictions, including use of the rental unit by a housing provider, demolition or condominium conversions, major remodeling, and Ellis Act withdrawals. Additionally, relocation fee amounts varied by duration of tenancy, and did not increase annually by any inflation factor.

The City did not previously require relocation fees for Chapter 6 Tenant evictions. Among the more significant changes enacted by the RSO Amendments was a new requirement that housing providers pay relocation fees for specified categories of no-fault evictions and no-cause evictions to Chapter 6 Tenants. The RSO Amendments also added identical schedules of relocation fees to both Chapter 5 and Chapter 6 that are adjusted annually based on annual percentage increase in the Consumer Price Index ("CPI").

There is a long history of requiring compensation for involuntary tenant evictions associated with governmental actions under federal[7] and state[8] law, and while these laws are not applicable to the RSO, this general type of relocation assistance requirement was extended to certain categories of private eviction actions with the enactment of local rent regulations and other tenant protection ordinances adopted in many California jurisdictions since the late 1970s. In general, relocation assistance requirements seek to balance two competing objectives: (1) compensating tenants for replacement housing costs associated with involuntary, no-fault evictions, including out-of-pocket moving costs and for the foregone financial benefit of remaining in a regulated unit, as compared with a replacement market-rate unit; and (2) protecting the housing provider's ownership rights, which include the right to self-occupy a unit, maintain and improve their property and/or go out of the rental business either through demolition or conversion to non-residential uses.[9]

During a series of professionally-facilitated dialogue sessions between Beverly Hills housing providers and tenants living in buildings subject to the RSO, following adoption of the RSO Amendments, tenants articulated several positions regarding the RSO Amendment relocation assistance payment changes, including the following:

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[4] Beverly Hills Municipal Code ("BHMC), Title 4, Chapter 5, Article 5, Section 4-5-501 through Section 4-5-508.

[5] BHMC, Title 4, Chapter 5, Article 5, Sec. 4-5-513. The Ellis Act is the subject of a separate HR&A Issue Paper.

[6] BHMC, Title 4, Chapter 5, Article 5, Sec. 4-5-509; Sec. 4-5-511; and Sec. 4-5-512; and Chapter 6, Sec. 4-6-9.

[7] Federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended, and the Housing and Community Development Act of 1974, as amended.

[8] California Uniform Relocation and Assistance and Real Property Acquisition Act of 1969, as amended.

[9] Hamilton, Rabinovitz & Alschuler, *The 1994 Los Angeles Renal Housing Study: Technical Report on Issues and Policy Options*, prepared for the City of Los Angeles Housing Dept., Dec. 1994, at p. 287-288.

- The amount of relocation fees should be adjusted annually at the same amount as the allowed annual rent increase (i.e., the greater of three percent or the applicable CPI), rather than based on only on annual changes in the CPI;
- Relocation fees should be paid by the housing provider at the time he or she notifies the City of an involuntary termination;
- In addition to the relocation fee structure for permanent evictions, a relocation fee structure should be established for temporary evictions on a per-diem basis;
- Relocation fees should reflect estimated actual costs households will incur to relocate;
- Relocation fees should extend compensation to households in 3-bedroom apartments;
- Relocation fees should be increased for protected classes of tenants to $3,000, and an additional $1,500 should be awarded for each additional member of any protected tenant class; and
- Relocation fees should include lost wages and other accountable costs. [10]

Housing providers in Beverly Hills articulated the need to have adequate safeguards and limits to protect both tenants and housing providers. Housing providers positions on relocation fees included the following:

- The amount of the relocation fee should be limited to two times the current monthly rent, as opposed to three times;
- There should be a limit to the number of times an individual tenant can receive relocation fees, for example, one time every five years;
- Relocation assistance eligibility should be based on tenant financial means; there should be an income cap on tenant eligibility for relocation assistance; and
- The City should accumulate data regarding the frequency of housing providers' relocation fee payments.[11]

Beverly Hills Context

Under the RSO Amendments, housing providers in Beverly Hills are required to pay relocation fees to Chapter 5 and Chapter 6 Tenants under circumstances specified in each Chapter, but these circumstances differ based on the type of involuntary termination of tenancy. Chapter 6 requires relocation fees for all no-fault and no-cause evictions, and Chapter 5 requires relocation fees specifically for evictions for dwelling use by a housing provider, demolition or condominium conversion, major remodeling, and Ellis Act withdrawals. The different circumstances under which Chapter 5 and Chapter 6 Tenants receive relocation fees are based primarily on the different eviction protections for Chapter 5 and Chapter 6; therefore, changes to the relocation fee requirements would need to be based on changes to the eviction protections for each chapter.

Chapters 5 and 6 refer to the same schedule of relocation fees based on the number of bedrooms in the unit from which a tenant is evicted and whether there is a senior citizen, disabled person, or minor present in the evicted household, as shown in Figure 1.[12] These fee amounts are adjusted annually based on the percentage increase in the CPI for Los Angles-Riverside-Orange County area.

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[10] Tenants Positions, Relocation Fees, Beverly Hills Renters Alliance, http://bhrentersalliance.org/wp-content/uploads/2017/09/RELOCATION-FEES-2017-8-31.pdf

[11] Beverly Hills City Council Agenda Report, September 5, 2017.

Figure 1: Chapter 5 and Chapter 6 Relocation Fees, 2018

Unit Type	Base Relocation Fee ("Eligible Tenants")[1]	Relocation Fees for Household with a Senior Citizen, Disabled Person, and/or a Minor ("Qualified Tenants")
Studio	$6,193	$8,193
One Bedroom	$9,148	$11,148
Two+ Bedrooms	$12,394	$14,394

Source: BHMC Title 4, Chapter 5, Sec. 4-6-9; and Chapter 6, Sec. 4-5-605.

Comparison with Other California Cities with Rent Regulation

Including Beverly Hills, 11 of 14 (i.e. 79%) California cities with residential rent regulation programs require some form of relocation assistance for tenants who experience no-fault evictions, as shown in Figure 2.

Notably, only Mountain View restricts tenant eligibility for relocation assistance based on household income. Relocation fees are available to all tenant households subject to that city's rent regulation system whose income does not exceed 120 percent of the median household income for the County as adjusted for household size according to the United States Department of Housing and Urban Development.

[12] In Chapter 5, a tenant is a "senior" if he or she is over 62 years, a "minor" if he or she is less than 18 years old, and "disabled" if receiving benefits from a federal, state, or local government, or from a private entity due to a permanent disability that prevents the person from engaging in regular, full time employment. Chapter 6 utilizes the same definitions for minor and disabled, but does not include a definition for a senior.

Figure 2: Summary of California Rent Stabilization Programs with Relocation Fee Requirements for No-Fault Evictions, 2018

City	Requires Relocation Fees
Beverly Hills	✓
Berkeley	✓
East Palo Alto	✓
Hayward	
Los Angeles	✓
Los Gatos	
Mountain View[1]	✓
Oakland	✓
Palm Springs	
Richmond	✓
San Jose	✓
San Francisco	✓
Santa Monica	✓
West Hollywood	✓
Percentage	**79%**

[1] Limits eligibility for relocation assistance to households that earn 120% or less of the applicable Area Median Income.

Source: HR&A Advisors, Inc. and the individual cities

Relocation Fee Variables

As shown Figure 3, like Beverly Hills, the relocation fee requirements in most of these cities vary based on tenant types and the number of bedrooms in a unit from which a tenant is evicted, and adjust relocation fee amounts based on annual CPI changes. A minority of these cities vary relocation fee amounts based on type of eviction, duration of tenancy, or the nature of apartment building ownership. In summary:

- All 10 of the other cities in California that require relocation fees provide some difference in fees for "Eligible Tenants" (i.e. all tenants eligible to receive relocation assistance) versus "Qualified Tenants" (i.e. generally refers to senior citizens, disabled people, or tenant households with minors, but sometimes also includes tenants of specified low-income levels);
- All the other cities adjust relocation fees annually by changes in the applicable CPI;
- A majority (64%) of cities, including Beverly Hills, differentiate fee amounts by the number of bedrooms in a unit;
- Just over one-third (36%) of cities, not including Beverly Hills, vary relocation fee amounts by type of eviction, and typically do so by differing fees between temporary and permanent relocation. Richmond also provides a separate fee schedule for evictions due to owner move-in and San Francisco provides a separate fee schedule for evictions due to the Ellis Act;
- A few (27%) cities vary the amount of relocation fees by duration of tenancy; and
- One city (Los Angeles) has differing relocation fees based on the nature of property ownership, with one schedule for housing providers who own no more than four residential units and a single-

family home (defined as "Mom and Pop Landlords") and a different schedule for owners of buildings with more than four units.[13]

Figure 3: Relocation Fee Amount Variables, 2018

City	Number of Bedrooms in Unit	Qualified vs. Eligible Tenants	Type of Eviction	Duration of Tenancy	Nature of Ownership	Adjusted by CPI
Beverly Hills Chapter 5	✓	✓				✓
Beverly Hills Chapter 6	✓	✓				✓
Berkeley		✓	✓			✓
East Palo Alto[1]		✓		✓		✓
Los Angeles		✓		✓	✓	✓
Mountain View[2]	✓	✓				✓
Oakland	✓	✓				✓
Richmond	✓	✓	✓			✓
San Jose	✓	✓				✓
San Francisco		✓	✓			✓
Santa Monica	✓	✓	✓			✓
West Hollywood	✓	✓				✓
Percentage	**64%**	**100%**	**36%**	**18%**	**9%**	**100%**

[1] In addition to a base relocation fee, tenant's duration of tenancy, and whether the tenant is qualified or eligible, East Palo Alto also requires the owner to pay actual moving costs up to $2,500.

[2] Mountain View's relocation fees vary case by case. A housing provider is required to provide a full refund of a tenant's security deposit, a 60-day subscription to a rental agency, the cash equivalent of three months' rent, based on the average monthly rent for a similarly-sized unit in Mountain View, and an additional $3,000 per unit if the household has Qualified Tenants.

Source: HR&A Advisors, Inc. and the individual cities

Definition of "Qualified" Tenants

Although all California cities that require relocation assistance for no-fault evictions differentiate fee amounts for "qualified" tenants versus "eligible" tenants, the definition of qualified tenant varies by city. All cities include senior, disabled, and minor tenants in their definition of a qualified tenant, but some cities (36%) also include lower-income tenants in this definition, as shown in Figure 4.[14]

Furthermore, among the eight cities that do not define lower-income tenants as Qualified Tenants, two cities (Los Angeles and West Hollywood), have separate fee amounts for lower-income tenants, defined as tenants whose household income is 80% of the Area Median Income (AMI) or less. West Hollywood, for example,

[13] City of Los Angeles Relocation Information. http://hcidla.lacity.org/Relocation-Assistance

[14] In the cities of Berkeley, East Palo Alto, Oakland, and San Jose, a "lower-income" tenant is as defined by Health & Safety Code Section 50079.5.

has a flat fee for low-income tenants regardless other factors, such as the number of bedrooms in the unit. The fee amount for low-income tenants is $21,517, about 33% higher than the fee amount for non-low-income tenants residing in 3+ bedroom units.

Figure 4: Definition of Qualified Tenants, 2018

City	Does Not Include Lower-Income Tenants	Includes Lower-Income Tenants
Beverly Hills	✓	
Berkeley		✓
East Palo Alto		✓
Los Angeles	✓	
Mountain View	✓	
Oakland		✓
Richmond	✓	
San Jose		✓
San Francisco	✓	
Santa Monica	✓	
West Hollywood	✓	
Percentage	**64%**	**36%**

Source: HR&A Advisors, Inc. and the individual cities

Relocation Fee Calculation

When updating the relocation fee amounts under the RSO Amendments, Beverly Hills based its fee calculation on methods employed by Los Angeles, Santa Monica, and West Hollywood, which incorporate local moving costs, potential differences in rents incurred by moving out of a regulated unit, and other start-up costs experienced when moving to a new residence. Accordingly, City staff included three factors in its calculation of relocation fees for the RSO Amendments: average local moving expenses, utility start-up costs, and three months of average monthly rents by type of unit, to account for first and last month's rent and a security deposit.[15]

Berkeley uses a similar fee calculation formula, but includes the cost of one month of storage space, and does not include utility costs.[16] Mountain View's relocation fee amounts include the cost of a 60-day subscription to a rental agency, in addition to the equivalent of three months median market rent for a similarly sized unit and a full refund of a tenant's security deposit.

[15] Beverly Hills City Council Agenda Report, February 21, 2017, Item G-2; http://beverlyhills.granicus.com/MetaViewer.php?view_id=49&clip_id=5472&meta_id=322948

[16] City of Berkeley Request for Relocation Payment from Property Owner; https://www.cityofberkeley.info/uploadedFiles/Housing/Level_3_-_General/ReolcationPaymentRequest_30daysOrMore%202018(1).pdf

Relocation Fee Amount Comparisons

As shown in Figure 5, the City's adopted relocation fee amounts are roughly aligned with those in West Hollywood, which is located immediately adjacent to Beverly Hills and has a similar housing market, utility start-up costs, and moving costs. Fees in both Beverly Hills and West Hollywood are lower than in Santa Monica, due primarily to a larger difference between rent-stabilized rents and market-rate rents in that city.

Figure 5: Relocation Fee Amounts of Nearby Cities with Comparable Housing Markets, 2017

Beverly Hills		West Hollywood		Santa Monica	
Eligible		*Eligible*		*Eligible*	
Studio	$6,193	Studio	$6,455	Studio	$8,650
1 Bed	$9,148	1 Bed	$9,114	1 Bed	$13,300
2+ Beds	$12,394	2 Beds	$12,277	2+ Beds	$18,050
		3+ beds	$16,202		
Qualified		*Qualified*	$17,087	*Qualified*	
Studio	$8,193	*Lower-Income*	$21,517	Studio	$16,359
1 Bed	$11,148			1 Bed	$15,350
2+ Beds	$14,394			2+ Beds	$20,750

Source: Beverly Hills City Council Agenda Report, February 21, 2017.

Policy Options

Based on the foregoing information and data calculations, HR&A suggests that there are at least three plausible policy options that the City Council, City staff, and the public could consider when determining how to treat relocation fees in the RSO:

1. **No Policy Change:** In this case, the City would continue its relocation fee requirements as they exist currently, both in terms of the eviction categories for which relocation fees are required (including different application of the requirements to Chapter 5 versus Chapter 6 Tenants), and the amounts of the fees.
    - **Advantages to housing providers:** There would be little or no advantages to housing providers.
    - **Disadvantages to housing providers:** Housing providers would continue to be required to pay relocation fees for no-fault evictions, including higher fees for evicted households in which a senior citizen, disabled person, or minor live. There would be no opportunity for reduced relocation fees in future years, should fee components decline over time (e.g., reductions in rents or moving and utility start-up costs).
    - **Advantages to tenants:** The existence of relocation fees may discourage housing providers from carrying out no-cause and no-fault evictions. But for those that do occur, tenants would continue to be compensated. Evicted households containing a senior citizen, disabled person, or minor, as well as tenants in units with more bedrooms, would continue to be compensated with a higher fee.
    - **Disadvantages to tenants:** There would be little or no disadvantages to tenants.

Administrative Considerations: This option maintains current requirements, and therefore would not require any additional City staff time or other resources.

2. **Alter Fee Amounts to Account for Additional Criteria:** The City could add further variation in required relocation fee amounts to attempt to proportionally align fee amounts with the types of units and buildings being vacated, and the types of tenants being evicted, based on one or more specific criteria used by other cities with rent regulation, possibly including:
    a. Tenant financial circumstances (e.g., fees could be stratified based on household income, with higher fees paid to lower income tenants like in West Hollywood);
    b. Duration of tenancy (e.g., fees could differ based on how long a tenant has occupied a unit); and/or
    c. Type of evictions (e.g., fees could differ based on the circumstances under which tenancy is terminated, including potentially creating a separate fee structure for temporary repairs as a modest per diem payment for up to 30 days).

    - **Advantages to housing providers:** Varying the relocation fee further by specific tenant and eviction characteristics could benefit housing providers by more closely aligning relocation fees with actual relocation expenses.
    - **Disadvantages to housing providers:** A more complex relocation fee system could involve more management time and could result in higher fees for some tenant categories.
    - **Advantages to tenants:** Varying relocation fees by detailing the criteria further by nature of eviction and type of tenant could allow tenants subject to all types of evictions to receive payments better aligned with household circumstances, type of eviction, and moving expenses.
    - **Disadvantages to tenants:** Changes to the relocation fee regime may incentivize housing providers to prefer certain tenants over others. For example, if housing providers are required to provide higher relocation fees for long-term, low-income tenants, they may instead seek higher earning tenants who are more likely to move voluntarily.

    Administrative Considerations: This option would require additional City staff time or other resources to research and prepare new fee schedules, and draft and assist in enacting the required RSO amendments. There may also be additional costs associated with monitoring and enforcing a more complex fee schedule, and mediating any related disputes.

3. **Eliminate Relocation Requirements and Fees:** In this case, the City would remove its relocation fee provision for Chapter 5 and/or Chapter 6 Tenants.
    - **Advantages to housing providers:** Housing providers would be able to conduct no-cause and no-fault evictions without paying any relocation fees, and more readily take advantage of vacancy decontrol.
    - **Disadvantages to housing providers:** The are little to no direct disadvantages to housing providers, but removal of the fees after they were enacted by the RSO Amendments could result in new housing provider-tenant tensions and conflict.
    - **Advantages to tenants:** There are no advantages to tenants.
    - **Disadvantages to tenants:** Absent some alternative form of tenant protections from no-fault evictions, this could encourage more no-fault evictions and potentially cause increased

housing instability and dislocation for tenants, particularly under a combination of RSO Amendment rent increases and continuation of vacancy decontrol.

Administrative Considerations: This option would require modest additional City staff time or other resources to draft and assist in enacting the required RSO amendments. There may also be some cost savings because City staff would no longer have to monitor or enforce the relocation requirements and fees, or update the fees annually. However, any cost savings may be offset by the need for increased staff response to address tenant concerns.

HR&A ADVISORS, INC.
ANALYSIS OF BUILDINGS WITH FOUR UNITS OR LESS IN THE BEVERLY HILLS RENT STABILIZATION CONTEXT

HR&A Analyze. Advise. Act.

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DRAFT MEMORANDUM

To:	Honorable Mayor and City Council, City of Beverly Hills
From:	HR&A Advisors, Inc.
Date:	July 26, 2018
Re:	Analysis of Buildings with Four Units or Less in the Beverly Hills Rent Stabilization Context

The City of Beverly Hills (the "City" or "Beverly Hills") retained HR&A Advisors, Inc. ("HR&A") to provide independent research and analysis about seven policy issues related to recently enacted changes to the City's Rent Stabilization Ordinance (the "RSO").[1] This Issue Paper addresses whether, and if so how, the City Council might consider amending the RSO to exempt multifamily buildings with two, three and/or four units per building, which are now regulated by the RSO.

The Issue Paper begins with a general statement about the issue, notes some of the positions about it that have been mentioned in public discussions about the RSO, and summarizes how this issue is addressed by 13 other California cities with multifamily building rent regulation, based on review of their ordinances and regulations and through discussions with city representatives. The Issue Paper then presents data from various sources that have a bearing on the issue, including the relevant numbers of two to four-unit buildings and apartment units in Beverly Hills, other characteristics of these buildings, available data on the households who rent them,[2] and financial data about their operating costs and real estate value. The data used in this Issue Paper are drawn from multiple sources, some of which are specific to Beverly Hills, such as the City's RSO rental registry,[3] data from the Beverly Hills Unified School District ("BHUSD"), and the U.S. Census Bureau, and some of which utilize data for a more general area around the City, because City-specific data are not available.[4] Based on the information and data provided on this topic, the Issue Paper concludes with a set of plausible policy options for City Council, City staff, and public consideration.

[1] Ordinance Number 17-O-2729, adopted in April of 2017 (the "RSO Amendments").

[2] As discussed in HR&A's Draft Beverly Hills RSO Data Brief ('Data Brief"), the relatively small scale of the City means that the U.S. Census Bureau Public Use Microdata Sample ("PUMS"), which makes it possible to cross-tabulate multi-family household characteristics with the number of units per multifamily building, is not available (i.e., the geographic area applicable to PUMS data is generally an area with a population of about 100,000 people). Therefore, data such as household incomes in two to four-unit buildings versus buildings with more units, is not available.

[3] The RSO Registry file provided to HR&A by the City on March 21, 2018 includes three properties containing a total of 17 units that are recorded as having been built after 1995. Because rents for properties built after 1995 cannot legally be controlled pursuant to the Costa-Hawkins Rental Housing Act, HR&A excluded these three properties and 17 units from the analysis contained in this report. The three properties and 17 units that were excluded represent less than a percent of all RSO properties and units, and their exclusion from the analysis is therefore assumed have a *de minimis* impact on the general characteristics of buildings subject to the RSO.

[4] More detail about all data sources can be found in the separate HR&A Data Brief.

Statement of the Issue

The City's RSO currently applies to multifamily apartment buildings with two or more units, which has been the case since rent regulation was first established in the City in 1978, and this coverage universe did not change in the RSO Amendments. During a series of professionally-facilitated dialogue sessions between Beverly Hills housing providers and tenants living in buildings subject to the RSO following adoption of the RSO Amendments, housing providers raised the issue of whether regulated buildings with between two and four units (i.e. duplexes, triplexes, and quadplexes) should be exempt or subject to different regulations than buildings with five or more units.[5] Some housing providers posited that there is a fundamental difference in real estate financial characteristics and tenant profiles for buildings with fewer than five units compared to buildings with five or more units. Additionally, some housing providers argued that duplexes, triplexes, and quadplexes should be exempt from the RSO because they believe the typical management, building operation, and relationships with tenants in these buildings differ materially from large multifamily buildings. Some observed that the operation of these smaller buildings more closely resembles single-family homes or condominiums, which are exempted from the RSO. The Beverly Hills Renters Alliance has expressed the view that all tenants need rent regulation and eviction protections provided by the RSO Amendments, regardless of the number of units in a multifamily building.[6]

Comparison to Other California Cities with Rent Regulation

Besides Beverly Hills, 13 other California cities currently have residential rent regulation programs. As shown in Table 1, four cities (31%) do not exempt buildings by number of units (i.e., the current situation in Beverly Hills), while the other nine cities (69%) exempt multifamily buildings with two, three and/or four units, although the specifics of these exemptions vary. Four cities (31%) exempt duplexes only; three cities (23%) exempt duplexes and triplexes; and two cities (15%) exempt duplexes, triplexes and quadplexes.

Table 1 – Summary of Rent Stabilization Program Exemptions by Number of Units in Multifamily Buildings in Other California Cities

	No Exemptions by Number of Units in Multifamily Buildings	Duplexes	Duplexes and Triplexes	Duplexes, Triplexes, and Quadplexes
Total Number of Cities	4	4	3	2
Percentage of Cities	31%	31%	23%	15%
Cities	West Hollywood San Francisco Richmond Los Angeles	San Jose Mountain View Berkeley Los Gatos	East Palo Alto Oakland Santa Monica	Hayward Palm Springs

Source: HR&A Advisors, Inc. and the individual cities

[5] Based on HR&A communications with City staff, and documented in September 5, 2017 City of Beverly Hills City Council Agenda Report (http://beverlyhills.granicus.com/MetaViewer.php?view_id=49&clip_id=5722&meta_id=341890)

[6] Dialogue #6 Takeaway, Tenants Positions, Beverly Hills Renter Alliance (bhrentersalliance.org2017/08/dialogue-6-my-takeaway/)

Four of the nine cities that exempt two to four-unit buildings do not limit them in any way (i.e., San Jose, Mountain View, Los Gatos and Hayward), but the other five cities qualify their exemptions by conditions of simultaneous building owner occupancy or other building ownership requirements. These stipulations include the following:

- **City of Berkeley**: exempts duplexes only if one unit was owner-occupied in 1979 and is currently owner-occupied.
- **City of East Palo Alto**: exempts duplexes and triplexes only if one of the units is currently occupied as the primary residence of the owner, or relative of the owner, who has occupied the unit for a period of one year or longer.
- **City of Oakland:** exempts duplexes and triplexes only if one unit is occupied by the owner as his or her primary residence.
- **City of Palm Springs**: exempts duplexes, triplexes, and quadplexes only if one unit is occupied by the owner as his or her primary residence.
- **City of Santa Monica:** exempts duplexes and triplexes only if an owner with at least a 50 percent interest in the property, who is a natural person (i.e., not a legal entity), occupies a unit on the property.

Most cities with exemptions for buildings with fewer than five units do not state a specific rationale for the exemptions in their rent regulation ordinances. However, the City of Oakland, which exempts duplexes and triplexes, states a specific rationale for doing so in its ordinance:

> "The City Council believes the relationship between landlords and tenants in smaller owner-occupied rental properties involve special relationships between owners and tenants residing in the same smaller property. Smaller property owners also have a difficult time understanding and complying with rent and eviction regulation. The Just Cause Eviction Ordinance recognizes this special relationship and exempts from its coverage owner-occupied buildings divided into a maximum of three units. For these reasons, the City Council believes owner-occupied rental properties exempt from the Just Cause Eviction Ordinance should similarly be exempt from the Rent Adjustment Program so long as the property is owner-occupied."[7]

Similarly, an administrator in Santa Monica's Rent Control Department summarized in a discussion with HR&A that the intention behind that city's exemption for duplexes and triplexes was that the relationship between tenants and an owner living on site is likely to be more congenial. For example, the owner may be more responsive and sensitive to tenant needs, concerns, as well as unit maintenance. An administrator of the Mountain View ordinance noted in another discussion with HR&A that while their ordinance was drafted by a tenant's coalition, the rationale for the exemption may have been that a housing provider who owns a duplex often lives in one unit and rents out the other unit, and therefore is more likely to have a direct and personal relationship with tenants than is typical for buildings with more units.

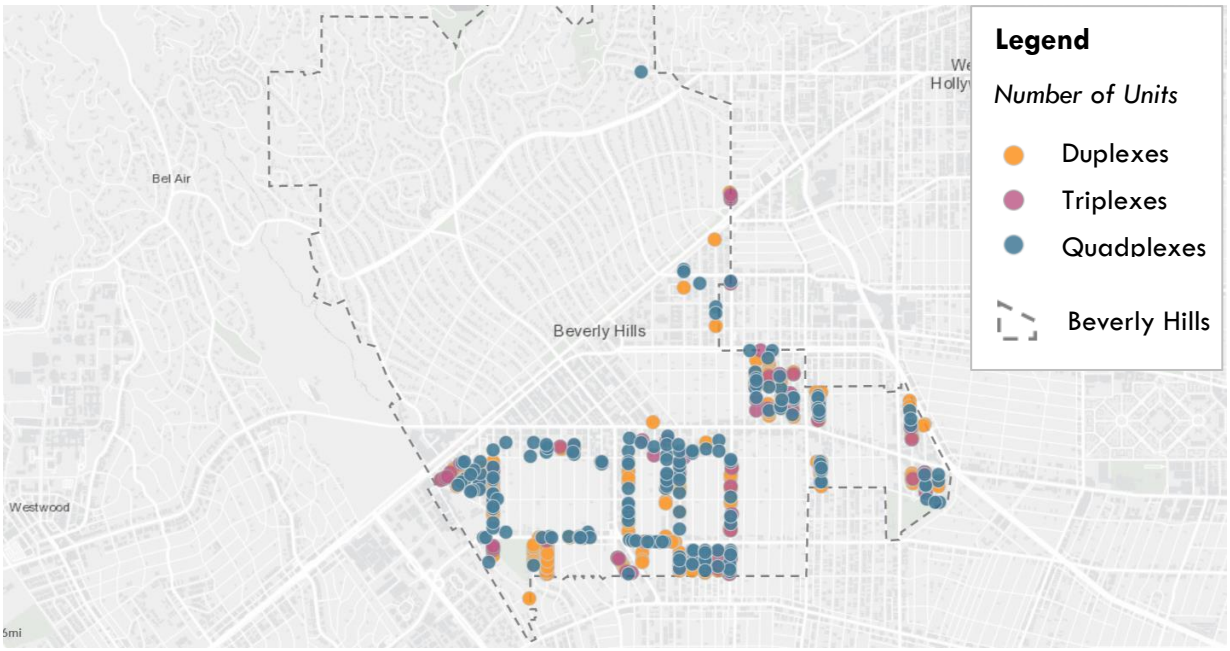
Relatedly, while Los Angeles does not wholly exempt properties from rent stabilization based on the number of units in structures, its rent stabilization provisions allow "mom and pop" property owners, who are defined as owners of no more than four residential units and a single-family house within the City of Los Angeles, to pay reduced relocation fees to their tenants in cases of eviction for owner or relative occupancy and comply with certain additional conditions. One of the conditions for reduced relocation fees is that the building containing the unit subject to eviction must contain four or fewer rental units.

[7] Oakland Municipal Code, Chapter 8.22.010: Findings and Purpose, Residential Rent Adjustments and Evictions.

The Beverly Hills Context

As shown in Figure 1, most multifamily buildings with less than five units in the City are quadplexes. Nearly all multifamily buildings with four units or less are located in the southern portion of the City, below Santa Monica Boulevard.

Figure 1 - Map of Multifamily Properties in Beverly Hills, 2017



Source: City of Beverly Hills

Inventory

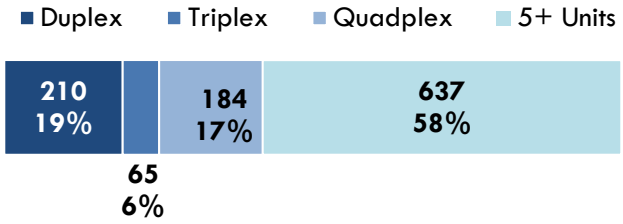
In Beverly Hills, as shown in Figure 2, multifamily buildings subject to the RSO ("RSO Buildings") with four units or less compose more than 40 percent of all RSO Buildings, including 210 duplexes, 65 triplexes, and 184 quadplexes. However, as shown in Figure 3, buildings with four units or less compose less than 20 percent of total inventory of units subject to the RSO ("RSO Units"), including 420 units in duplexes, 192 in triplexes, and 732 in quadplexes.

Building Stock Characteristics

RSO Buildings with four units or less are generally older buildings compared with the rest of the RSO multifamily stock in Beverly Hills. As shown in Figure 5, nearly 98 percent of the RSO buildings with four units or less were built prior to 1960 and more than 80 percent were built before 1940.

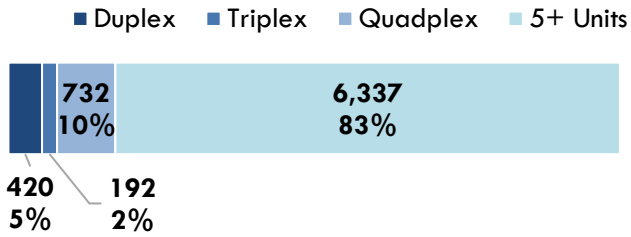
As shown in Figure 4, RSO Buildings with four units or less have more bedrooms per unit than buildings with five or more units. Three-bedroom units make up more than three quarters of units within duplexes, while they account for only four percent of units within buildings with five or more units.

Figure 2 - RSO Buildings by Number of Units in Structure in Beverly Hills, 2017



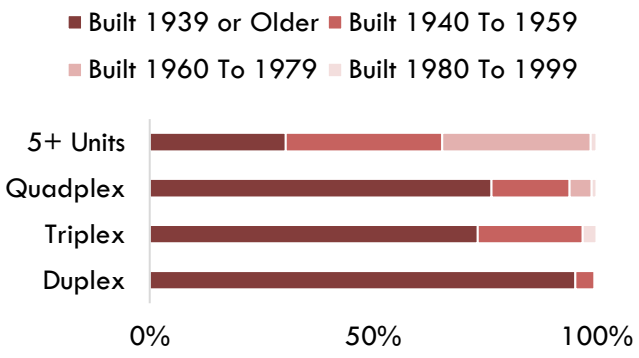
Source: RSO Registry

Figure 3 - RSO Units by Number of Units in Structure in Beverly Hills, 2017



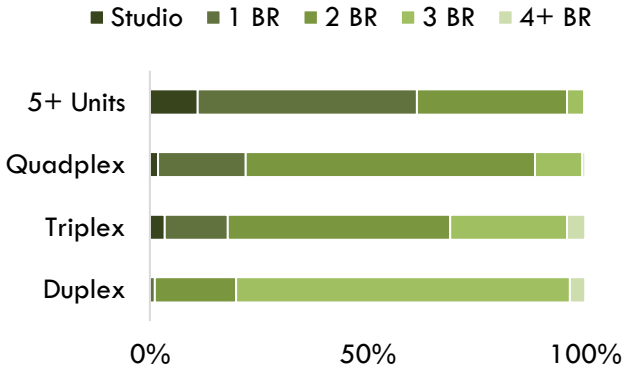
Source: RSO Registry

Figure 5 - RSO Buildings by Number of Units in Structure by Year Built in Beverly Hills, 2017



Source: RSO Registry

Figure 4 - RSO Unit Type Distribution by Number of Units in Structure in Beverly Hills, 2017

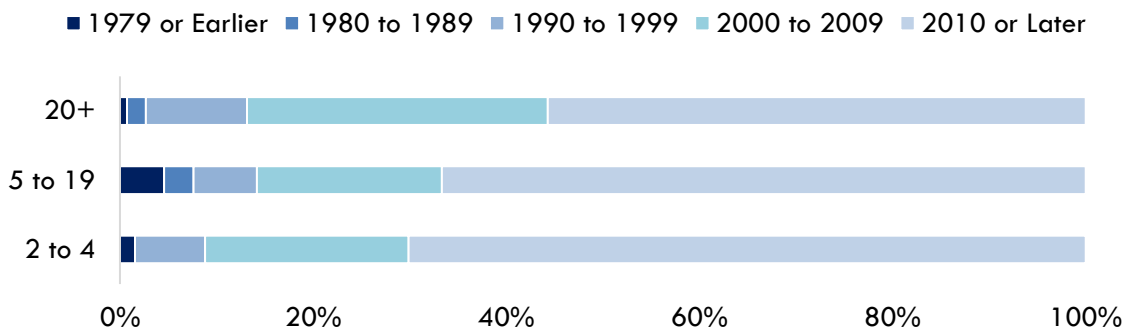


Source: RSO Registry

Tenant Turnover

Tenants in buildings with two to four units have generally moved into their units more recently than those in buildings with five or more units, although the difference is slight. Specifically, 70 percent of tenants in buildings with two to four units moved into their unit in 2010 or later, and 91 percent moved into their unit in 2000 or later. This relatively high rate of tenant turnover has two types of financial implications for housing providers. On the one hand, it increases operating costs to prepare the unit for the next tenant, and to advertise for and screen candidate tenants. But, pursuant to the Costa-Hawkins Rental Housing Act,[8] it also provides an opportunity to raise rents on voluntarily vacated units to market levels, which are then de-controlled under the RSO until the next voluntary vacancy. From a tenant's perspective, this pattern also means that the financial benefits of rent regulation accruing to long-term stayers applies to a small percentage of households in these units (i.e., nine percent moved in prior to 2000).

Figure 6 - Year Renter Householder Moved into Unit by Number of Units in Structure in Beverly Hills, 2016

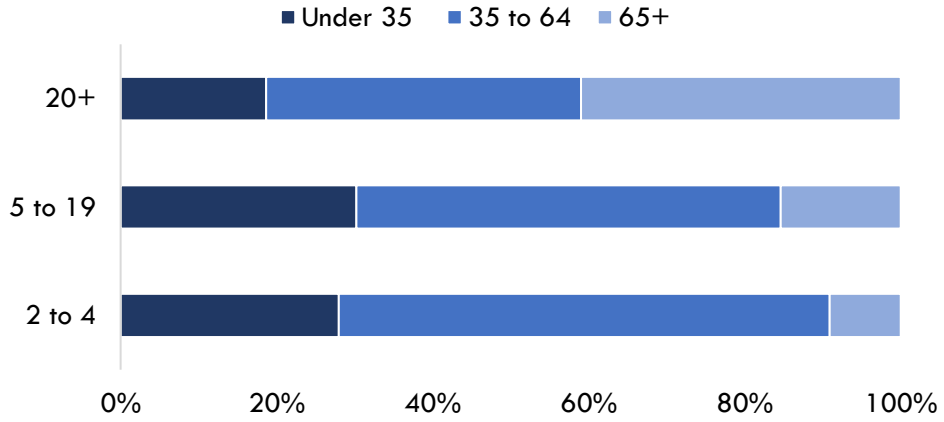


Source: 2012-2016 American Community Survey 5-Year Estimates

Tenant Household Profile

As shown in Figure 7, buildings with two to four units have householders that are predominantly working-age (35 to 64), while seniors tend to locate in buildings with more than 20 units.

Figure 7 - Distribution of Renter Householders by Age of Householder by Number of Units in Structure in Beverly Hills, 2016

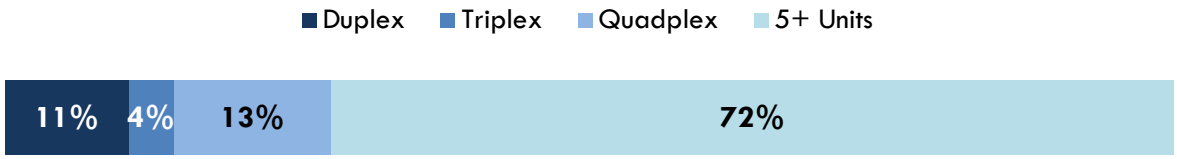


Source: 2012-2016 American Community Survey 5-Year Estimates

[8] California Civil Code Section 1954.50

There are 1,107 RSO households with over 1,700 students attending schools in the BHUSD as of May 2018, according to BHUSD data analyzed by HR&A.[9] The data further indicate that approximately 42 percent of total BHUSD enrollment resides in rent-stabilized housing. Or stated another way, the 1,107 RSO households with children enrolled in the BHUSD make up 14 percent of the total 7,681 RSO units in the City. Among those RSO households with students in the BHUSD, nearly three quarters live in buildings with five or more units, as shown in Figure 8. Thus, any changes to RSO provisions related to buildings with between two to four units would impact slightly more than a quarter of households with a total of 518 children enrolled in the BHUSD.

Figure 8: Distribution of RSO Households with Children Enrolled in the BHUSD by Number of Units in Structure, 2018

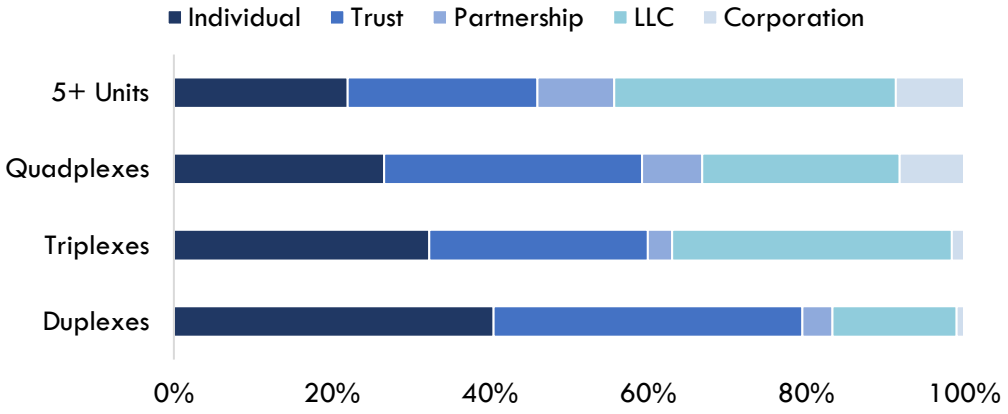


Source: RSO Registry; BHUSD

Ownership Profile

As shown in Figure 9, RSO Buildings with four or less units represent a larger share of regulated apartment buildings owned by individuals and trusts, as opposed to other more corporate ownership entities (i.e., partnerships, LLCs and corporations), than buildings with five or more units. This may be attributable to broader real estate investment dynamics: real estate companies and corporate investors tend to have greater access to investment capital allowing them to acquire larger apartment buildings, which are generally more valuable properties than smaller buildings in the same market. Conversely, individuals and trusts (assuming these are family trusts) generally have more limited access to investment capital, and may seek to acquire smaller, less expensive rental buildings.[10]

Figure 9 - RSO Building Ownership by Type of Entity by Number of Units in Structure in Beverly Hills, 2017



Source: RSO Registry

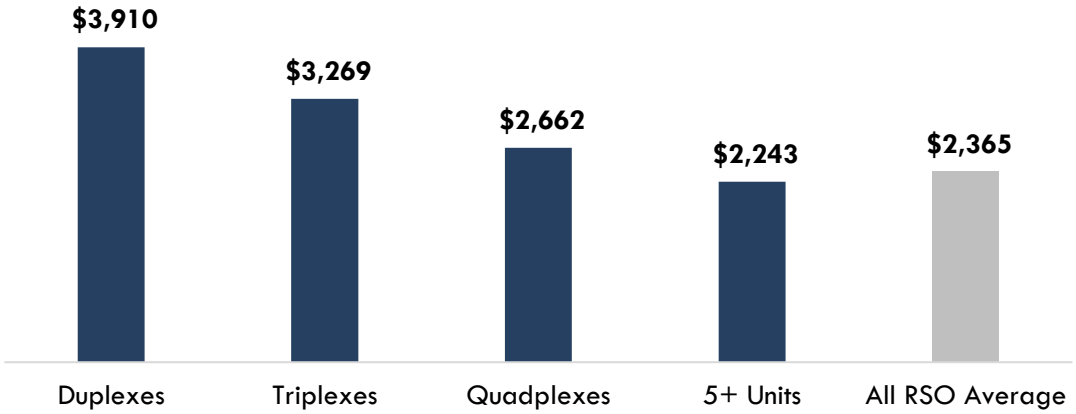
[9] HR&A analysis of enrolled student data provided by BHUSD and RSO Registry data.

[10] This is a generalization, of course, since individuals can form Limited Liability Companies (LLC) and corporations, too.

Characteristics of Building Operations and Financials

As shown in Figure 10, RSO Buildings with four units or less achieve higher average monthly rents per unit than those with five or more units. Average monthly rents for all RSO Units are $2,365 per unit, and rents inversely correlate with the number of units in a building; duplexes achieve the highest average rents of $3,910 per unit per month, while RSO buildings with five or more units achieve average rents of $2,243 per unit per month. This pattern reflects the fact that units with more bedrooms have higher average rents (as documented in HR&A's separate Data Brief) and two to four-unit buildings tend to have more of these larger units, as noted above in Figure 4.

Figure 10 - Average Monthly Rents per RSO Unit by Number of Units in Structure in Beverly Hills, 2017

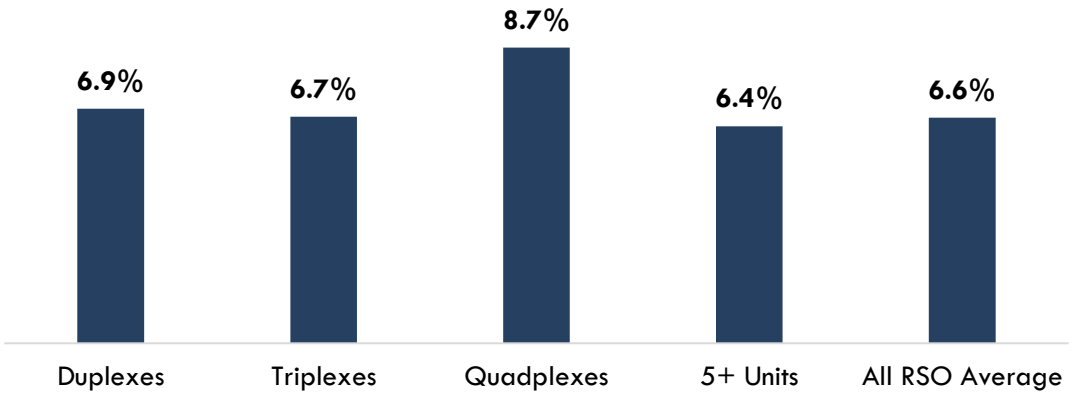


Source: RSO Registry

Although U.S. census data for household incomes by number of units in a multifamily building are not available, it is possible to infer the general scale of household incomes in two to four-unit buildings based on Citywide rent-to-income ratios, which are reported in the Data Brief. Thus, if tenant households in two to four-unit buildings are paying the Citywide median rent-to-income ratio of 30.7 percent, applying this ratio to the average rents shown in Figure 10 implies that average annual household incomes in duplexes are about $153,000, in triplexes, about $128,000, in quadplexes about $104,000, as compared to about $88,000 in buildings with five or more units. Individual household circumstances undoubtedly vary from these general averages.

As shown in Figure 11, RSO Buildings with four units or less also have slightly higher vacancy rates. The vacancy rate for all RSO units is 6.6 percent on average, although buildings with four and fewer units are above this average, while buildings with five or more units are slightly below it. However, this data is for one point in time. Vacancy rates have a different meaning in buildings with fewer units as compared with buildings with more units. For example, a duplex with one vacant unit is 50 percent vacant while a 10-unit building with one vacant unit is 10 percent vacant.

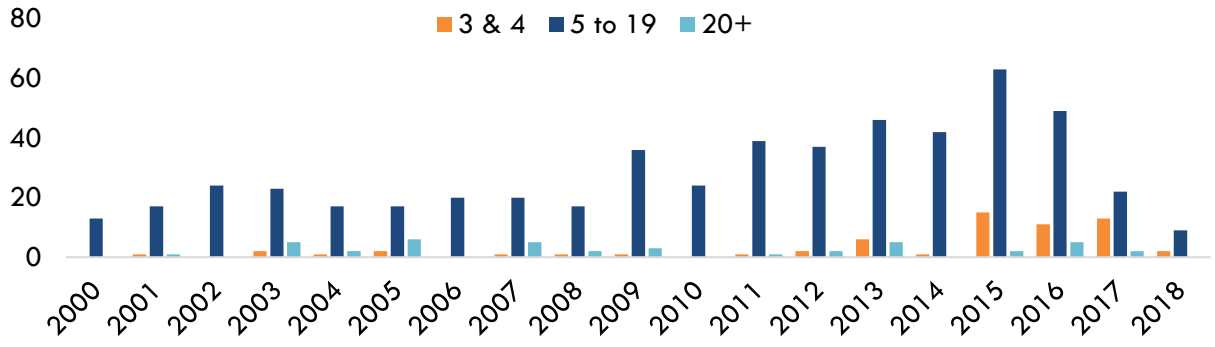
Figure 11 - RSO Vacancy Rate by Number of Units in Structure in Beverly Hills, 2017



Source: RSO Registry

As shown in Figure 12, annual multifamily property sales in the City (and particularly sales of triplexes and quadplexes) remained at very modest levels between 2000 and through the Great Recession (2007-2009), including a real estate market peak just before that recession. The annual pace of multifamily sales increased for all scales of buildings beginning with the end of the recession, peaked in 2015, and has since then tailed off to levels more like the beginning of the decade. This trend also holds for triplexes and quadplexes, but still at much lower volumes than for buildings with more units. More specifically, there have been 535 total sales for buildings with 5 to 19 units since 2000 compared with 60 total sales for three- and four-unit buildings and 41 total sales for 20-plus unit buildings over the same period.[11] Even during the recent peak of sales years (2015-2017) for triplexes and quadplexes, the volumes were only 11 to 15 buildings each year.

Figure 12 - RSO Multifamily Property Sales by Number of Units in Structure in Beverly Hills, 2000-2018



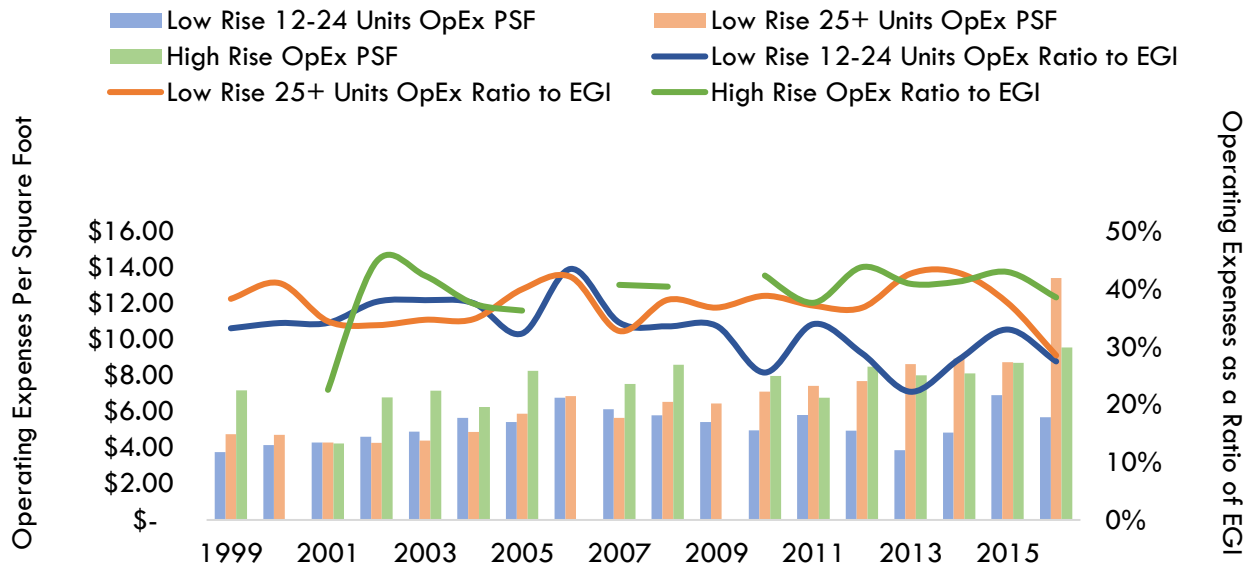
Source: CoStar

[11] Sales data for duplexes are not included in Figure 11 due to Costar data constraints.

There are currently no available independent data for operating expenses specific to apartment buildings in Beverly Hills. HR&A attempted to obtain operating expense data for an analytically robust and representative sample of local housing providers, but HR&A's request to the Apartment Association of Greater Los Angeles for assistance in doing so was declined. In lieu of data specific to Beverly Hills apartment buildings, HR&A analyzed annual data collected by the Institute of Real Estate Management ("IREM") for apartments within the Los Angeles Metropolitan Area as a general indicator of operating expense trends in relatively smaller versus relatively larger apartment buildings. IREM distinguishes apartment properties by size as low-rise (three stories or less) with 12 to 24 units, low-rise with more than 24 units, and high-rise (four or more stories with an elevator). IREM does not collect data for two to four-unit buildings.

As shown in Figure 13, annual operating expenses per square foot for all apartment types in the Los Angeles Metropolitan Area increased between 1999 and 2016, although operating expenses were generally higher for larger buildings over this period. Between 1999 and 2016, operating expenses per square foot averaged approximately $5.20 for low-rise buildings with 12 to 24 units, $6.70 for low-rise buildings with 25 or more units, and $7.60 for high-rise buildings. Over the same period, the ratio of operating expenses to effective gross income ("EGI") varied from year to year, but generally stayed within the range of 30 to 40 percent. On average, low-rise buildings with 12 to 24 units had the lowest operating expense to EGI ratio with 33 percent, while low-rise buildings with 25 or more units had a 37 percent ratio and high-rise buildings had a 40 percent ratio.

Figure 13 - Operating Expenses ("OpEx") Per Square Foot and as a Ratio of Effective Gross Income ("EGI") in the LA Metro Area, 1999-2016



Source: IREM. Data gaps in some years reflect missing survey data.

Policy Options

Based on the foregoing information and data, the case for continuing to regulate rents for buildings with two to four units is supported by the fact that altogether, they represent about 42 percent of RSO buildings (and 17% of RSO units); they house about 24 percent of BHUSD students; they experience higher turnover rates, meaning that rents reset to market rates more frequently; and annual operating expenses for smaller buildings are generally lower than those for larger buildings.

Conversely, the case for exempting some combination of buildings with two to four units is supported by how the majority of other California cities with rent regulation address this issue, as well as the data that suggest that tenants in these buildings are predominantly working age and are better positioned to afford market rate rents than seniors who predominantly live in buildings with more units; tenants in these buildings already pay higher rents and therefore presumably have higher household incomes; these buildings are generally much older and therefore may incur more costly capital improvements not easily accommodated by current rent regulations; and owners of these buildings tend to be individuals or families whose financial situation may be more sensitive to price controls on their assets than professional real estate investors who tend to own buildings with more units.

Considering the foregoing information and data, HR&A suggests that there are at least four plausible policy options that the City Council, City staff, and the public could consider when determining whether, and if so how, to treat duplexes, triplexes, and quadplexes in the RSO:

1) **No Policy Changes:** In this case, the City would continue to regulate all buildings now subject to the RSO, with no exemptions for two to four-unit buildings.
    - **Advantages to housing providers:** Little to no advantages for housing providers overall, although housing providers of buildings with fewer units would continue to enjoy comparatively higher rents and lower operating expenses than those with buildings with more units.
    - **Disadvantages to housing providers:** All RSO housing providers, regardless of the unique physical and operational characteristics of their buildings, would continue to be limited in their ability to increase rents and evict Chapter 5 Tenants, and would pay the same amount of relocation fees for eligible evictions.
    - **Advantages to tenants:** All RSO tenants would maintain rent increase protections and Chapter 5 tenants would maintain eviction protections regardless of the number of units in their building.
    - **Disadvantages to tenants:** Little to no disadvantage to tenants overall.

    Administrative Considerations: This option would not require additional City staff time or resources, or produce any savings, because it would maintain existing conditions.

2) **Exempt Only Duplexes and/or Triplexes with No Limitations:** In this case, the City would exempt only those multifamily buildings with the fewest units per building, and the smallest share of the currently regulated multifamily stock, but without any of the ownership limitations adopted by some other cities with rent regulation.
    - **Advantages to housing providers:** Housing providers with duplexes and/or triplexes would be free to increase rents to market level, would not pay any relocation fees (absent a separate Just-Cause Ordinance or other tenant protection measures) and would have generally greater eviction and administrative flexibility.

- **Disadvantages to housing providers:** Housing providers with buildings of four or more units would continue to be limited in their ability to increase rents and evict Chapter 5 Tenants.
- **Advantages to tenants:** The majority of RSO tenants would still benefit from RSO protections.
- **Disadvantages to tenants:** Tenants of duplexes and/or triplexes would lose the rent limitation, relocation fee and Chapter 5 eviction protections contained in the RSO (absent a separate Just-Cause Ordinance or other tenant protection measures).

Administrative Considerations: This option would incur some limited staff time or other resources to draft and support adoption of the ordinance changes, but would not require additional on-going City staff time or resources, and could result in some cost savings by removing these units from the RSO Registry and associated monitoring and enforcement costs.

3) **Exempt Duplexes, Triplexes and Quadplexes with No Limitations:** In this case, the City would exempt all multifamily buildings with less than five units per building, but without any of the ownership limitations adopted by some other cities in California with rent regulation.
   - **Advantages to housing providers:** Housing providers with buildings with fewer than five units would be free to increase rents as high as the market will bear, and would have generally greater eviction and administrative flexibility.
   - **Disadvantages to housing providers:** Most housing providers (i.e., those with buildings more than four units), would continue to be limited in their ability to increase rents and evict tenants, despite having comparatively higher operating expenses than buildings with fewer units.
   - **Advantages to tenants:** The majority of RSO tenants would still benefit from RSO protections.
   - **Disadvantages to tenants:** Tenants of duplexes, triplexes, and quadplexes would lose the rent limitation, relocation fee and eviction protections contained in the RSO (absent a separate Just-Cause Ordinance or other tenant protection measures).

   Administrative Considerations: This option would require some limited staff time or other resources to draft and support adoption of the ordinance changes, but would not require additional on-going City staff time or resources, and could result in some cost savings by removing these units from the RSO Registry and associated monitoring and enforcement costs.

4) **Exempt or Modify Provisions for All or Some Combination of Duplexes, Triplexes and Quadplexes, But Only with Specified Owner Limitations:** In this case, any exemptions or modified provisions for buildings with less than five units would also include one or more of the onsite owner residency or related requirements discussed above in the rent regulation programs in Berkeley, East Palo Alto, Los Angeles, Oakland, Palm Springs and Santa Monica.
   - **Advantages to housing providers:** Certain housing providers, primarily individuals and families who own multifamily residential real estate, would benefit from a greater ability to increase rents and evict tenants.
   - **Disadvantages to housing providers:** Professional real estate investment entities would continue to have limited capacity to increase rents and evict tenants, and there may be individuals and families who own properties, but do not meet the established exemption criteria and could be comparatively disadvantaged.

- **Advantages to tenants:** The majority of RSO tenants would still benefit from RSO protections.
- **Disadvantages to tenants:** Tenants of exempt properties would lose rent and eviction protections.

Administrative Considerations: This option would require somewhat more staff time or other resources to research, draft and support adoption of the ordinance changes, and additional City staff time or other resources to track property ownership in the City, monitor compliance and conduct enforcement actions.

HR&A ADVISORS, INC.
EVALUATION OF "BANKING" UNUSED ANNUAL ALLOWABLE ADJUSTMENTS UNDER RENT STABILIZATION

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DRAFT MEMORANDUM

To:	Honorable Mayor and Council, City of Beverly Hills
From:	HR&A Advisors, Inc.
Date:	July 26, 2018
Re:	Evaluation of "Banking" Unused Annual Allowable Adjustments Under Rent Stabilization

The City of Beverly Hills (the "City" or "Beverly Hills") retained HR&A Advisors, Inc. ("HR&A") to provide independent research and analysis about seven policy issues related to recently enacted changes to the City's Rent Stabilization Ordinance (the "RSO").[1] This Issue Paper addresses the issue of whether the City Council should consider amending the RSO to allow housing providers to "bank," or reserve, percentages of unused annual allowable rent adjustment, to a further degree than the RSO allows currently only for Chapter 5 units under limited circumstances, as discussed below.

Other elements of allowable annual rent increases, such as certain surcharges that may be "passed through" by housing providers to tenants in the form of rent increases, or the formula for establishing the allowable percentage and/or dollar amount by which rents may be increased annually, and housing provider ability to charge market rents for voluntarily vacated units, are subjects of a separate HR&A Issue Paper on the "Maximum Annual Rent Increase Policies in the Beverly Hills Rent Stabilization Context."

This Issue Paper begins with a general statement about the issue, notes some of the positions about it that have been mentioned in public discussions about the RSO, and summarizes how this issue is addressed by 13 other California cities with rent regulation, based on a review of their ordinances and regulations and through discussions with city representatives. Based on the information provided on this topic, the Issue Paper concludes with a set of plausible general policy options for City Council, City staff, and public consideration.

Statement of the Issue

Under the RSO, housing providers can currently "bank" a portion of the allowable annual rent increase only for Chapter 5 Tenants, and only for those tenants with leases longer than one year that cap rent increases at an amount that is less than allowed by the RSO. The unused increases may be banked only for three years or less.[2] This provision is very limited in practical application, because: (a) Chapter 5 Tenants account for

[1] Ordinance Number 17-O-2729, adopted in April of 2017 (the "RSO Amendments"). The City's Rent Stabilization Ordinance (the "RSO") regulations are included in Beverly Hills Municipal Code ("BHMC") Title 4, Chapter 5 ("Chapter 5") and Chapter 6 ("Chapter 6"). Tenants residing in RSO units subject to regulation under Chapter 5 are hereinafter referred to as "Chapter 5 Tenants;" and Tenants residing in RSO units subject to regulation under Chapter 6 are hereinafter referred to as "Chapter 6 Tenants."

[2] Pursuant to Beverly Hills Municipal Code Section 4-5-310, which also allows housing providers to increase rents upon the expiration of leases longer than one year for Chapter 5 Tenants for capital expenditures and/or certain utility surcharges incurred by the housing provider over the term of a respective lease, provided that the lease contract did not allow for rent increases.

only four percent of all RSO units;[3] and (b) multi-year leases are a relatively rare apartment leasing practice.

One of the key changes in the April 2017 RSO amendments was to limit the ability for housing providers to increase annual rents for Chapter 6 Tenants by the greater of the annual percent change in the Consumer Price Index ("CPI") for the Los Angeles-Riverside-Orange County area or three percent, as compared with the 10 percent annual rent increase previously allowed by the original 1978 RSO.

During a series of professionally-facilitated dialogue sessions between Beverly Hills housing providers and tenants living in buildings subject to the RSO following adoption of the 2017 RSO amendments, housing providers raised the possibility of including a provision in the RSO to allow them to "bank" unused annual rent increases in a given year and add them on top of allowable rent increases in future years. Absent such a provision, a "use it or lose it" perception could prompt housing providers to more frequently increase rents to the maximum percentage allowed each year, rather than prior practice in which rent setting was governed more often by real estate market conditions and tenant retention strategies.

For example, under this approach, if a housing provider is allowed the maximum annual increase of the greater of three percent or the annual percentage change in the CPI under the current RSO Amendments, but raised rent for a unit by only two percent in a given year, banking the unused one percent would allow the housing provider to raise rent for that unit by up to four percent (maximum annual allowable three percent plus the previously unused one percent) in a future year. This could enable housing providers with more flexibility to manage year-to-year variation in market conditions and annual operating expenses. On the other hand, banking could introduce less predictability about annual rent increases for tenants.

Comparison to Other California Cities with Rent Regulation

In addition to Beverly Hills, 13 other California cities currently have residential rent regulation programs. As shown in Table 1, 10 cities (71%), including Beverly Hills, have some form of rent banking provision as a component of their rent regulation programs. However, most cities also limit the application of rent banking, including the total percentage with any banked percentage by which rent can be increased annually, how long unused increases may be held, and tenant categories that may be subject to banked increases based on their tenure, among others.

[3] Per City of Beverly Hills RSO Registry data provided to HR&A on March 21, 2018.

Table 1 – Summary of California Cities with Rent Banking Provisions as Part of Rent Stabilization Programs, 2018

	Cities with Rent Banking Provisions	Cities without Rent Banking Provisions
Total Number of Cities	10	4
Percentage of Cities	71%	29%
Cities	Beverly Hills (Chapter 5)[1] Berkeley East Palo Alto Hayward Los Gatos Mountain View Oakland San Francisco Santa Monica West Hollywood	Los Angeles Palm Springs Richmond San Jose

[1] Beverly Hills Municipal Code Section 4-5-310.

Source: HR&A Advisors, Inc. and the individual cities

As shown in Table 2, cities generally limit the maximum amount that banked rents can be increased annually, commonly set at 10 percent, to prevent tenants from facing unexpected sharp rent increases. However, both Berkeley and San Francisco allow rent increases with no maximum specified percentage with banking. Beverly Hills also does not have an established percentage limit for banked increases, but potential increases are effectively limited by the provision's narrow application to Chapter 5 Tenants with leases longer than one year for which unused increases may only be banked for up to three years. In Santa Monica and West Hollywood, banked rent increase limits are not based on unused percentage changes, but instead are determined by the Maximum Allowable Rent ("MAR") resulting from per-unit cumulative annual rent increases allowed by each city's decisionmakers, based on data for each unit registered with the two cities. This approach effectively allows a housing provider to "catch up" to currently allowable maximum rents. For example, if a housing provider currently charges $800 per month for a unit and the MAR for that unit is $900 per month, the housing provider may increase the rent for that unit by $100 per month (+12.5%). Also shown in Table 2, most cities with banking provisions, other than Berkeley and Hayward, impose other limitations beyond rent increase maximums. There are no other uniformly applied limitations among the cities.

Table 2: Banking Provision Detail by Applicable City, 2018

	Allowable General Rent Adjustment	Banking Provisions	
		Maximum Increase with Banking	Other Limitations
Beverly Hills - Chapter 5	Lesser of 8% or CPI	No limit	Only applies to Chapter 5 apartment units with leases > 1 year and lease restricts the amount of the rent below the amount allowed by the RSO and capped at three years of unused increases
Berkeley	65% x CPI, but not more than 7%	No limit	None
East Palo Alto	80% x CPI	10%	Cannot bank more than three unused annual general adjustments during a tenant's occupancy
Hayward	5%	10%	None
Los Gatos	Greater of 70% x CPI or 5% x existing monthly rent	10%	Unused increases one year can only be applied in the following year
Mountain View	100% x CPI, but not less than 2% or more than 5%	10%	Ability to accumulate does not carry over to next property owner
Oakland	100% x CPI	10%	May not be more than three times the annual adjustment in the year it's applied, and banked increases not used within 10 years expire
San Francisco	60% x CPI, but not more than 7%	No limit	Only increases after 1982 can accumulate
Santa Monica	75% x CPI	Based on Maximum Allowable Rent	None
West Hollywood	75% x CPI	Based on Maximum Allowable Rent	Only uncharged increases between 1985 and 1996 can be charged to a tenant whose tenancy started before 1996

Source: HR&A Advisors, Inc. and the individual cities

Some studies for cities with existing or considering new rent regulations that included a review of the banking issue, including East Palo Alto,[4] Richmond,[5] and San Jose[6], cite the potential administrative challenges posed by the regulatory complexity and costs associated with tracking, maintaining, and enforcing banking provisions. However, HR&A discussed this issue with an official at the City of Santa Monica's Rent Control

[4] https://www.ci.east-palo-alto.ca.us/DocumentCenter/View/2049

[5] https://www.ci.richmond.ca.us/DocumentCenter/View/45357

[6] https://www.bizjournals.com/sanjose/news/2017/02/01/san-jose-places-5-percent-limit-on-some.html

Board who stated that they do not face any added administrative encumbrance due to the allowance of banking. The official explained that this is because the City has a regularly updated rent registry system that calculates the MAR for each registered unit, allowing City staff to expeditiously check the differences between the actual rents a housing provider has charged for any given unit in comparison with the MAR for that same unit. Even so, were Beverly Hills to permit banking, some degree of additional City staff time and registration system data management cost would be required to track and administer the details of a banking system for individual units in each building subject to the RSO on an annual basis.

Other issues that may need to be considered if a banking provision were to be added to the RSO include whether to impose a percentage cap, as most cities with a banking system do; whether subsequent owners could assume any remaining banked rent increase authority at the time of sale; and whether the number of such banking increases should be limited during a continuing tenancy.

Policy Options

Based on the foregoing information and data, HR&A suggests that there are at least four plausible policy options the City Council, City staff, and the public could consider, individually or in combination, when determining whether to allow RSO housing providers to bank unused annual general adjustments in future years:

1) **No Policy Changes:** In this case, the City would continue to allow the narrow ability for housing providers to bank rent increases for Chapter 5 Tenants with leases that are longer than one year,but exclude the ability for housing providers to bank unused rent increases for Chapter 6 Tenants.
    - **Advantages to housing providers:** Chapter 5 housing providers only would maintain the ability to bank unused increases for tenants with leases longer than one year, and no additional administrative effort would be required to implement banking procedures for Chapter 6 Tenants.
    - **Disadvantages to housing providers:** Chapter 6 housing providers could not apply any portion of the unused maximum annual adjustments in future years, limiting the ability to pay for future year operating expenses that might exceed expenses in the year during which the maximum allowable increase was not utilized, or respond to improved real estate market conditions, and could limit the ability to implement a tenant retention strategy based on maintaining lower-than-allowable rents.
    - **Advantages to tenants:** Tenants would benefit from more predictable annual rent increases currently allowed by Chapter 5 and Chapter 6, and would avoid potential unexpected rent increases which could vary from year to year when banked increases might be imposed on top of annual allowable increases.
    - **Disadvantages to tenants:** With the recent RSO change reducing the maximum allowable rent increase, Chapter 6 housing providers may be more inclined to apply the full allowable rent increase each year as a hedge against year-to-year variation in operating expenses.

Administrative Considerations: Due to limited applicability of the current RSO banking policy, there would not be any change in current City costs to administer the RSO.

2) **Remove the Current Multi-Year Lease Term Restriction on Use of Banking for Chapter 5 Tenants:** In this case, the City would allow housing providers to bank unused allowable rent increases for

Chapter 5 Tenants regardless of the lease term, but would still limit the cumulative banking provision to three years.

- **Advantages to housing providers:** Chapter 5 housing providers would be able to more flexibly utilize unused allowable rent increases and this ability would not be constrained to only tenancies of more than one year.
- **Disadvantages to housing providers:** Chapter 6 housing providers would still not be able to bank unused allowable rent increases, and Chapter 5 housing providers may be encumbered by unit-by-unit record keeping and reporting.
- **Advantages to tenants:** Chapter 6 Tenants would not be subject to possibly unexpected banked rent increases. Chapter 5 Tenants would still likely experience only generally limited rent increases, due to other Chapter 5 limitations, which would limit additional annual rent increases from banking. Chapter 5 Tenants may not experience maximum allowable rent increases because housing providers would have the ability to bank unused increases.
- **Disadvantages to tenants:** Chapter 5 Tenants with one-year or less lease terms could be subject to unexpected banked rent increases to which they are not currently subject, while Chapter 6 Tenants could experience somewhat higher annual rent increases if housing providers decide to apply the full allowable rent increase each year in in the absence of any ability to bank unused allowable rent increases.

Administrative Considerations: This policy option would significantly increase City administrative costs as the City would need to administer a survey to Chapter 5 housing providers and Tenants to determine if any of those units are subject to a lease with a term that is longer than a year. A survey of this kind would be time-consuming for the City to administer and may not yield complete results.

3) **Adopt a Banking Provision for Both Chapter 5 and Chapter 6 Tenants without Limitations:** In this case, the City would allow housing providers the greatest flexibility regarding banked rent increases.
    - **Advantages to housing providers:** Provides housing providers the ability to carry over unused maximum rent increases from year to year for both Chapter 5 and Chapter 6 Tenants, and charge rents more closely aligned with changes in market rent and operating expense trends, and greater flexibility in using lower rents as a tenant retention strategy.
    - **Disadvantages to housing providers:** Little to no disadvantage, other than required unit-by-unit record keeping and reporting.
    - **Advantages to tenants:** Only the possibility that some housing providers (other than recent buyers with presumably higher mortgage costs) may be less inclined to impose the maximum annual rent increase each year, because they retain the flexibility to bank any differences between actual rent and maximum allowable rent to use as needed in a future year.
    - **Disadvantages to tenants:** Tenants could face sharp, unpredictable increases in rents when housing providers apply one or more banked increases at the same time.

Administrative Considerations: This policy option would require significant additional costs for the City to develop a new data system (or augment the new RSO Registry) to monitor current and historic rent amounts by each tenancy subject to the RSO, and the durations of each tenancy to adequately determine whether a proposed banked rent increase is permissible. In addition to ongoing updating and

maintenance of the rent and tenancy tracking system, this would require additional staff time to review and process proposed banked rent increases, and any disputes about them.

4) **Adopt a Banking Provision, but Limit the Total Amount that Rent May be Increased Annually and/or Apply Other Limitations:** In this case, the City would allow unused rent increases to be banked for use in future years for both Chapter 5 and Chapter 6 Tenants, but would limit the total amount that rent could be increased in a given year. The City could also add other limitations, such as how long unused increases could be banked, how many times a housing provider may bank rent increases, limit any carryover banking accruing to subsequent owners and/or limit the application of banking based on tenant tenure.
    - **Advantages to housing providers:** Provides the ability to charge rents more closely in line with market trends – i.e. charging rents below allowable levels in years when the market is weak or operating expenses are stable, and using that unused amount to capitalize on stronger markets or higher operating expenses in future years, and use lower rents as part of a tenant retention strategy.
    - **Disadvantages to housing providers:** Program limitations may prove cumbersome to administer and/or hinder the extent to which unused rent increases can be recaptured.
    - **Advantages to tenants:** An upper limit on annual increases in a given year with banking would provide some degree of certainty as to the total amount by which rents could potentially increase. Other limitations would reduce the extent to which tenants could be subject to banked increases.
    - **Disadvantages to tenants:** Tenants could face unexpected and unpredictable rent increases when housing providers apply one or more banked increases.

Administrative Considerations: Like Policy Option #3, this option would require significant additional City costs for data management, monitoring and other administrative tasks, but somewhat more cost than Policy Option #3, to track and monitor the additional specified banking limitations.

HR&A ADVISORS, INC.
NO-CAUSE EVICTION POLICIES IN THE BEVERLY HILLS RENT STABILIZATION CONTEXT

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DRAFT MEMORANDUM

To:	Honorable Mayor and Council, City of Beverly Hills
From:	HR&A Advisors, Inc.
Date:	July 26, 2018
Re:	No-Cause Eviction Policies in the Beverly Hills Rent Stabilization Context

The City of Beverly Hills (the "City" or "Beverly Hills") retained HR&A Advisors, Inc. ("HR&A") to provide independent research and analysis about seven policy issues related to recently enacted changes to the City's Rent Stabilization Ordinance (the "RSO").[1] This Issue Paper addresses whether, and if so how, the City Council might consider amending the RSO or other sections of the City's Municipal Code to adjust the procedures and remedies for "no-cause" evictions. The term no-cause eviction refers to involuntary termination of a month-to-month residential tenancy for which no cause or reason is cited by the housing provider.

The Issue Paper begins with a general statement about the issue as it has arisen in the context of the RSO, describes the City's current policies on no-cause evictions, highlights related positions mentioned in public discussions about the RSO Amendments, and summarizes how this issue is addressed by 13 other California cities with rent regulation, based on a review of their ordinances and regulations and through discussions with several of those cities' representatives. The Issue Paper then presents data from various sources that have a bearing on the issue, including The Eviction Lab at Princeton University and a data file prepared by the Beverly Hills Unified School District ("BHUSD") for rent-stabilized households with children enrolled in BHUSD. Based on the information and data provided on this topic, the Issue Paper concludes with a set of plausible policy options for City Council, City staff, and public consideration.

Statement of the Issue

The process of enacting the RSO Amendments has caused the City Council and City stakeholders to further evaluate RSO policy on no-cause evictions for Chapter 5 and Chapter 6 Tenants.

- No-cause evictions are involuntary terminations of tenancies for which no reason for eviction is stated by the housing provider.
- In contrast, "just-cause" evictions are involuntary terminations of tenancies for reasons established under California Code of Civil Procedure[2] or the terms of the RSO. Just-cause evictions include both

[1] Ordinance Number 17-O-2729, adopted in April of 2017 (the "RSO Amendments"). The City's Rent Stabilization Ordinance (the "RSO") regulations are included in Beverly Hills Municipal Code ("BHMC") Title 4, Chapter 5 ("Chapter 5") and Chapter 6 ("Chapter 6"). Tenants residing in RSO units subject to regulation under Chapter 5 are hereinafter referred to as "Chapter 5 Tenants;" and Tenants residing in RSO units subject to regulation under Chapter 6 are hereinafter referred to as "Chapter 6 Tenants."

[2] Calif. Code of Civil Procedure, Sec. 1161.

"at-fault" evictions and "no-fault" evictions, which generally have different noticing and procedural requirements.

- ✓ At-fault evictions are evictions for which the tenant is culpable and a specific legal reason is provided (e.g., failure to pay rent, maintenance of a nuisance, illegal uses, failure to execute a lease, refusal to provide unit access, or unapproved subtenants).[3]
- ✓ No-fault evictions are evictions for which the tenant is not culpable and a specific legal reason is provided (a decision by owners to move themselves and/or an immediate family member into a given rental unit, the withdrawal of units from the rental market pursuant to the Ellis Act,[4] conversion of apartment units to condominiums, or relocation necessitated by building renovation or demolition.)[5]

During a series of professionally-facilitated dialogue sessions between Beverly Hills housing providers and tenants living in buildings subject to the RSO following adoption of the 2017 RSO Amendments, tenants articulated a collective position to eliminate no-cause evictions, based on the following views:[6]

- Allowing no-cause evictions creates an atmosphere of fear in the resident base;
- The potential for no-cause evictions discourages tenants from reporting unsanitary or substandard dwelling unit conditions;
- No-cause evictions are used by some housing providers as a more procedurally convenient substitute for just-cause evictions;
- No-cause evictions contravene City Council interest in supporting residential stability;
- No-cause evictions pose potential harm to families with children in public schools;
- No-cause evictions pose potential harm to families for whom finding replacement housing in Beverly Hills is a challenge, given the very limited number of suitable units and the high demand for such units;
- No-cause evictions should be eliminated entirely, because there is no justifiable basis on which to allow housing providers to terminate tenancies capriciously or for any reason other than for-cause (i.e through due process); and
- While federal law bans housing discrimination, no-cause evictions enable housing providers to effectively discriminate on any basis.

Housing providers articulated a collective position to preserve no-cause evictions, for the following reasons:[7]

- No-cause evictions provide landlords a fair, economical, and efficient manner to terminate problem tenants; and
- No-cause evictions also benefit adversely affected tenants who want a disruptive tenant removed.

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[3] Beverly Hills Municipal Code ("BHMC"), Title 4, Chapter 5, Article 5, Section 4-5-501 through Section 4-5-508.

[4] BHMC, Title 4, Chapter 5, Article 5, Sec. 4-5-513.

[5] BHMC, Title 4, Chapter 5, Article 5, Sec. 4-5-509; Sec. 4-5-511; and Sec. 4-5-512; and Chapter 6, Sec. 4-6-9.

[6] City of Beverly Hills Human Services Division Memorandum, "Rent Stabilization Update," September 28, 2017, Attachment 1, p.23-24.
http://beverlyhills.granicus.com/MetaViewer.php?view_id=40&clip_id=5787&meta_id=344485

[7] Ibid.

However, housing providers also agreed that there need to be adequate no-cause eviction safeguards and limits to protect both tenants and landlords, such as:[8]

- A formula for the number of times no-cause evictions can be used within a specified period;
- Payment of reasonable relocation fees for no-cause evictions, including:
  - ✓ A limit to the number of times a tenant can receive relocation fees;
  - ✓ Financial criteria for a tenant to receive relocation fees; and
- The filing of a simple form with the City to enable the City to accumulate data regarding the frequency with which housing providers use no-cause evictions, and to ensure compliance with any applicable ordinance.

There is currently significant momentum in California to mitigate the adverse impacts of the statewide housing shortage and protect residents from the threat of displacement, including citizen initiatives to enact rent control in additional cities and/or enact new tenant protection ordinances, and proposed new laws in the State Legislature. With regards to no-cause evictions, in February 2018, a California Assembly Bill was proposed to prohibit rental owners statewide from terminating tenancies except for cause. The Bill was ultimately defeated in May 2018, but garnered considerable public attention and support.[9]

The Current Beverly Hills Context

Under the California Civil Code, no-cause evictions are legal for month-to-month tenancies in California unless local law states otherwise.[10] State law allows local jurisdictions to enact ordinances to regulate no-cause evictions ("Just-Cause Ordinances"). Just-Cause Ordinances preclude housing providers from evicting tenants from rent-stabilized units for no stated cause, and require specific reasons for initiating eviction proceedings against a tenant. In jurisdictions without Just-Cause Ordinances, housing providers can terminate month-to-month tenancies without a stated cause with prior written notice.

The RSO Amendments continue to prohibit no-cause evictions for Chapter 5 Tenants, but Chapter 6 generally does not address no-cause evictions in detail, other than requiring housing providers to pay relocation fees to evicted tenants and requiring housing providers to file a copy of a No-Cause Termination Notice (a required 60-day notice under State law for no-cause evictions) with the City within one week of noticing the tenant.

Additionally, if a housing provider re-rents a unit that was involuntarily vacated due to a no-cause eviction, the unit must be rented to the new tenant at the same price that the prior tenant paid. Pursuant to BHMC Section 4-6-5, housing providers may only increase rents to market rate for units that are voluntarily vacated or involuntarily vacated for the at-fault reasons stated in BHMC Section 4-6-5 (e.g., failure to pay lawful rent, lease terms violations, maintenance of a nuisance, illegal uses, failure to execute lease, refusal to provide unit access, and unapproved subtenants.)

Comparison with Other Cities in California

As of June 2018, Beverly Hills (per RSO Chapter 6) is one of only two California cities among 14 with a residential rent regulation program that allows no-cause evictions of tenants from rent-stabilized units (the

[8] Ibid.

[9] AB2925 (Bonta). https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB2925

[10] California Civil Code 1946.1.

other is the Town of Los Gatos). All other California cities with rent regulation programs have a Just-Cause Ordinance prohibiting no-cause evictions from rent regulated units.

Just-Cause Ordinances

Because Just-Cause Ordinances are not subject to Costa-Hawkins Rental Housing Act limitations,[11] they can either be implemented in connection with a city's rent regulation laws, barring no-cause evictions only from regulated units, or as a stand-alone ordinance barring no-cause evictions from units throughout the local rental market.[12] Just-Cause Ordinances may provide additional protections for certain types of tenants, such as persons with disabilities, elderly, terminally ill, families with school children and households with school employees.

Just-Cause Ordinances typically limit evictions to only a specific list of at-fault and no-fault reasons, and require the specific reason to be specified in the eviction notice provided to tenants and filed with the city, such as:

- Nonpayment of lawful rent;
- Material or habitual lease violation;
- Damage to the apartment;
- Refusal to sign a new lease agreement;
- Nuisance behavior;
- Refusing access to the apartment;
- Unapproved holdover subtenant;
- Capital improvements to the respective structure;
- Substantial rehabilitation to the respective structure;
- Sale of a unit that has been converted to a condominium;
- Ellis Act Removal[13];
- Owner move-in, or move-in of an immediate family member;
- Order to vacate by the Department of Housing and Urban Development; and
- Government-ordered vacation of an unpermitted apartment.

Comparative Approaches to Just-Cause Ordinances

Six cities (Berkeley, Hayward, Los Angeles, Oakland, Palm Springs, and San Francisco) have implemented Just-Cause Ordinances for units covered under their respective rent regulation laws, whereas six others (East Palo Alto, Mountain View, Richmond, San Jose, Santa Monica and West Hollywood) have implemented standalone Just-Cause Ordinances applicable to all rental units, regardless of whether the rents are also regulated, as shown in Figure 1 (Beverly Hills Chapter 6 and Los Gatos do not have just-cause municipal code provisions or ordinances).

[11] Costa-Hawkins Rental Housing Act establishes that certain units must be exempt from local rent control laws, including units with certificates of occupancy issued after February 1, 1995. Proposition 10 on the November 2018 statewide ballot proposes to repeal the Act.

[12] Just-Cause laws are also referred to as Good-Cause Laws in Berkeley and San Francisco.

[13] The Ellis Act, California Government Code Chapter 12.75, is a California state law that allows housing providers to evict tenants when removing units from the rental market. The Ellis Act is discussed in a separate HR&A Issue Paper.

Figure 1: Summary of California Rent Stabilization Programs with Just-Cause Laws, 2018

City	Just-Cause Ordinance Tied to Rent Regulation Ordinance	Just-Cause Ordinance Independent of Rent Regulation Ordinance
Beverly Hills (Ch. 5 only)	✓	
Berkeley	✓	
East Palo Alto		✓
Hayward	✓	
Los Angeles	✓	
Mountain View		✓
Oakland	✓	
Palm Springs	✓	
Richmond		✓
San Jose		✓
San Francisco	✓	
Santa Monica		✓
West Hollywood		✓
Percentage	**54%**	**46%**

Source: HR&A Advisors, Inc. and the individual cities

Cities with rent regulation programs have coupled rent level protections with Just-Cause Ordinances to more effectively promote stability for tenants covered under their system of regulations. Just-Cause Ordinances are intended to guard against abuse of the no-cause provision to vacate rent-stabilized units for the purpose of re-leasing units at market-rate rents, while preserving housing providers' legal rights to maintain rental properties, evict problem tenants and/or exercise other rights.[14]

Cities with standalone just-cause ordinances bar no-cause evictions for all units in the local rental market with few exemptions.[15] Cities that have considered standalone Just-Cause Ordinances that cover tenancies throughout the rental market have done so not only with the intention to protect a broader population of renters from arbitrary evictions, but also to simplify local laws and eliminate a two-tier system of tenant protections.[16] This approach also preserves no-cause eviction protections should local rent regulation be repealed in the future.

Several cities with rent regulations have reconsidered or amended their policies on no-cause evictions in recent years. In May 2017, San Jose enacted a new standalone Tenant-Protection Ordinance ("TPO") barring no-cause evictions. San Jose was the last of the Northern California cities with rent regulations to bar

[14] Los Angeles County Rental Market Analysis and Policy Development Framework, 21-September-2017.

[15] Exemptions to citywide just-cause laws vary, but may include: properties with three or fewer units, Section 8 units, care facilities, resident-owned nonprofit housing, and transient occupancy units.

[16] Andrew Khouri, "LA City Council takes first step to make evictions harder," *Los Angeles Times*, 28-June-2017; http://www.latimes.com/business/la-fi-eviction-protections-20170626-story.html

no-cause evictions. San Jose officials said the policy change was spurred by reports of more than 2,400 no-cause evictions in San Jose between 2010 and 2017.[17]

San Jose's TPO was contentious and continues to face protest from housing providers. As in Beverly Hills, San Jose housing providers argue that the just-cause provision limits their ability to manage properties and earn returns on investments in a very expensive housing market. San Jose housing providers also said that when seeking to evict a tenant for certain just-cause reasons, they are required to provide proof of nuisance behavior. They said that when dealing with problem tenants, issuing a no-cause eviction is a safer and more efficient process.[18]

The City of Los Angeles also began exploring policies to implement a Just-Cause Ordinance independent of the city's RSO in 2017.[19]

It should be noted, however, that a Just-Cause Ordinance regulating evictions, in the absence of rent regulation, can still lead to involuntary tenant displacement if rents are increased to an unaffordable level.

Eviction Data

Detailed eviction data for Beverly Hills is not available. However, the Eviction Lab at Princeton University collected, cleaned, geocoded, aggregated, and publicized all recorded court-ordered evictions between 2000 and 2016 in the United States. These data are useful for understanding the prevalence of evictions in general in Beverly Hills as compared with nearby cities and the region. But, it should be noted that because the dataset includes only court-ordered evictions, it does not capture evictions that do not result in a legal proceeding. Also, most cities nationwide do not require housing providers to state a reason when filing an eviction, the dataset does not track the relative occurrence of just-cause and no-cause evictions. Furthermore, the Eviction Lab *Methodology Report* notes that the eviction totals for California jurisdictions are probably understated, because "In California, many cases that end in eviction are sealed and therefore not accessible by the general public. In addition, it can be difficult to collect data from California as a whole, owing to restrictions on the number of records one can collect."[20]

Eviction rates in this database are defined as the number of evictions per 100 renter-occupied households annually. With the above data limitations in mind, Figure 2 shows that Beverly Hills had a somewhat higher overall eviction rate in 2016 (0.54%, including a total of 48 evicted households) than any of the nearby cities of Santa Monica, West Hollywood, and Los Angeles, but about the same rate as in Los Angeles County as a whole.[21] As shown in Figure 3, the annual eviction rate in Beverly Hills since 2000 has generally been on par with that of West Hollywood, but the rates in both cities have been higher than in Santa Monica. While eviction rates for the City and County of Los Angeles have fallen steeply by about 2.5 percentage points since 2000, according to these data, Beverly Hills eviction rates have fluctuated year to year and

[17] Ramona Giwargis "San Jose City Council approves policy against no-cause evictions," *The Mercury News*, 19-April-2017; https://www.mercurynews.com/2017/04/18/san-jose-city-council-hears-emotional-testimony-ahead-of-rent-protection-vote/

[18] Ramona Giwargis, "San Jose City Council approves historic new renter protections," *The Mercury News*, 21-April-2017; https://www.mercurynews.com/2017/04/19/san-jose-city-council-approves-historic-new-renter-protections/

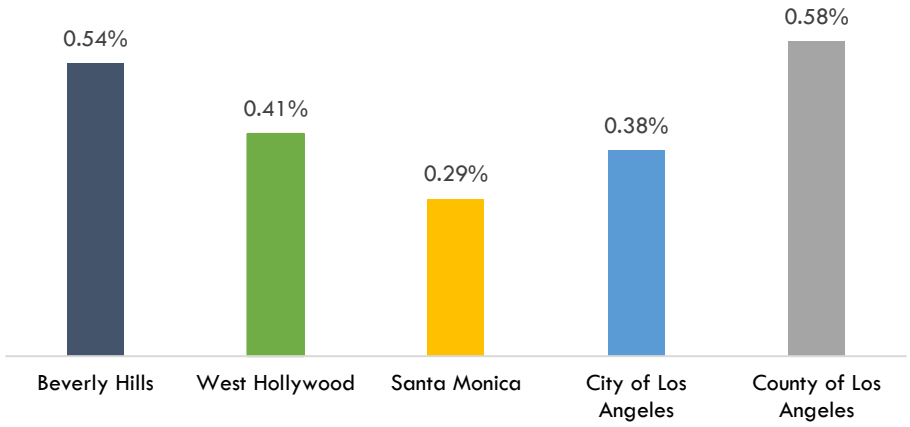
[19] Andrew Khouri, "LA City Council takes first step to make evictions harder," *Los Angeles Times*, 28-June-2017; http://www.latimes.com/business/la-fi-eviction-protections-20170626-story.html

[20] *Eviction Lab Methodology Report*: Version 1.0., Princeton: Princeton University, 2018, p.39, www.evictionlab.org/methods.

[21] Eviction Lab National Database: Version 1.0. Princeton: Princeton University, 2018, www.evictionlab.org.

declined only slightly, by about 0.5 percent, since 2000. As of 2016, the eviction rates in these jurisdictions have converged to about the same level, with Santa Monica consistently showing the lowest eviction rate over this period.

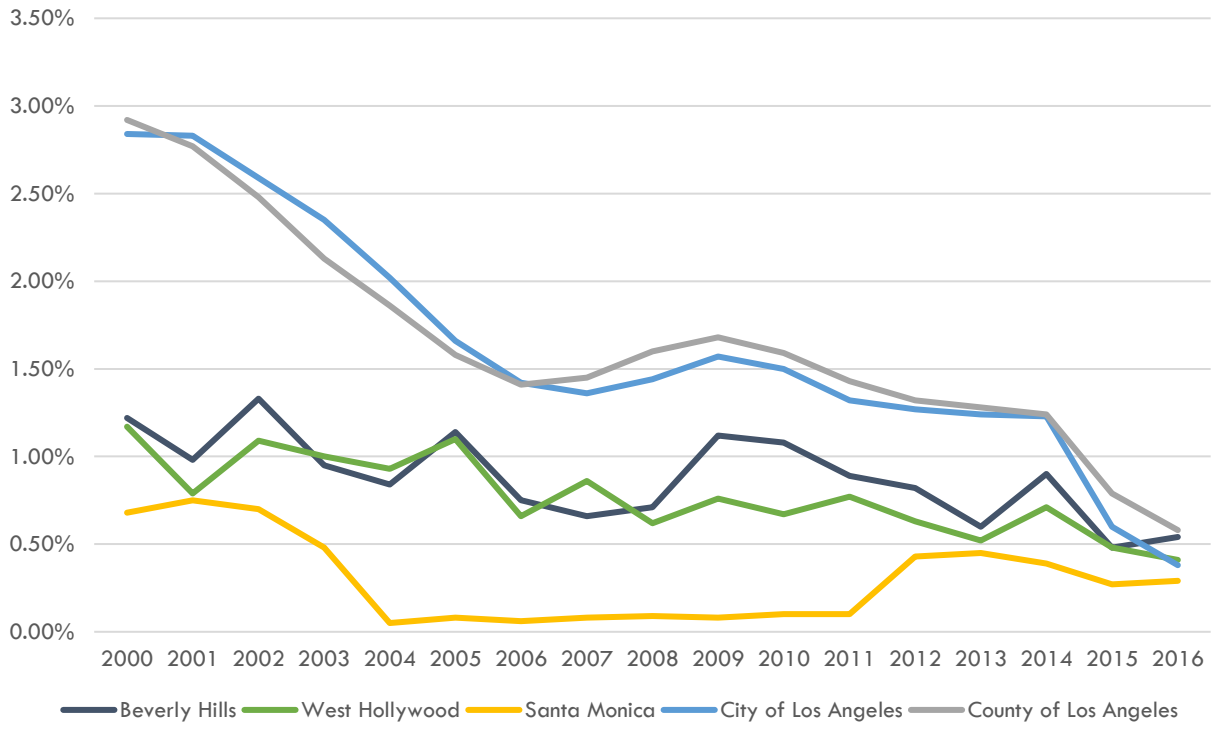
Figure 2: Comparison of Eviction Rates* with Nearby Cities and L.A. County, 2016



* An eviction rate is the number of evictions per 100 renter-occupied households

Source: The Eviction Lab at Princeton University and HR&A Advisors

Figure 3: Comparison of Beverly Hills Eviction Rates with Nearby Cities and L.A. County, 2000-2016



Source: The Eviction Lab at Princeton University and HR&A Advisors

Although there is no evidence to suggest that tighter eviction regulations cause reductions in the eviction rate, it is noteworthy that the cities of West Hollywood and Santa Monica have generally stronger eviction

regulations, and generally lower eviction rates, than Beverly Hills. More specifically, West Hollywood and Santa Monica have Just-Cause Ordinances preventing no-cause evictions throughout their entire rental markets. Additionally, Santa Monica further tightened eviction regulations in 2018 with an ordinance protecting educators and families with children under the age of 18 from all types of no-fault eviction during the school year.[22]

Regulating Evictions of Families with Children and Educators

A key concern raised by Beverly Hills tenants in the facilitated dialogue sessions on no-cause evictions was the need to protect families with children in local public schools.

There are 1,107 RSO households with over 1,700 students attending schools in the BHUSD as of May 2018, according to BHUSD data analyzed by HR&A.[23] The data further indicate that approximately 42 percent of the total BHUSD student population resides in rent-stabilized housing.

In addition to the Santa Monica ordinance noted above that protects educators and families with children under the age of 18 from all types of no-fault evictions during the school year, San Francisco and Berkeley have also both enacted similar ordinances.

When the City and County of San Francisco first approved its ordinance in 2016, San Francisco City Council presented studies with findings that low- and middle-income households displaced by no-fault evictions often could not afford to remain in San Francisco. A San Francisco City Councilmember said that local studies "overwhelmingly demonstrate[d] that moving homes in the middle of a school year can be harmful for children; school teachers and other staff tend to be especially vulnerable to displacement due to salary limitations; and mid-year evictions of school staff disrupt relationships that are important to children, interfere with the learning process, and burden our schools."[24] Berkeley voters also decided to amend that city's RSO in 2016 to eliminate owner move-in evictions of families with children during the school year.

San Francisco's ordinance was upheld by the California Court of Appeal in 2018, which led the Santa Monica City Council to introduce the same ordinance. Santa Monica City Council approved the ordinance in May 2018, saying of the new protection: "Education disruption brings immense challenges to young children and families if they are evicted or if their teacher faces eviction. This ordinance aligns with the City's values and commitment to tenant rights as well as our strategic goals to maintain an inclusive and diverse community."[25]

Moreover, the eviction of tenants with children has been studied as a major contributing cause of family homelessness in the United States. A study by the Los Angeles Mayor's Office for the United States

[22] Constance Farrell, "Santa Monica City Council Approves Ordinance to Enhance Tenant Protections for Educators and Students Facing No-Fault Evictions," *Santa Monica Daily Press*, 14-May-2018; http://smdp.com/santa-monica-city-council-approves-ordinance-to-enhance-tenant-protections-for-educators-and-students-facing-no-fault-evictions/166138

[23] HR&A analysis of enrolled student data provided by BHUSD and RSO Registry data.

[24] 20 Cal. App. 5th 510 (2018).

[25] Constance Farrell, "Santa Monica City Council Approves Ordinance to Enhance Tenant Protections for Educators and Students Facing No-Fault Evictions," *Santa Monica Daily Press*, 14-May-2018; http://smdp.com/santa-monica-city-council-approves-ordinance-to-enhance-tenant-protections-for-educators-and-students-facing-no-fault-evictions/166138

Conference of Mayors in 2013, found that eviction was the primary cause of family homelessness in Los Angeles, followed by family disputes and poverty.[26]

Policy Options for Beverly Hills

Based on the foregoing information and data, HR&A suggests that there are at least four plausible policy options that the City Council, City staff, and the public could consider when determining whether, and if so how, to address no-cause evictions (and recognizing that some options can be combined, such as #2 and #3):

1. **No Policy Change:** In this case, the City would continue to prohibit no-cause evictions for Chapter 5 Tenants only and permit housing providers to evict Chapter 6 Tenants without a specific cause, but continue requiring them to pay relocation fees and file a copy of the eviction notice with the City, as now required by the RSO Amendments.
    - **Benefits to housing providers:** Under current requirements, Chapter 6 housing providers would retain the ability to evict any month-to-month tenant without a court order or other administrative process, and maintain the existing flexibility of the current eviction process.
    - **Disadvantages to housing providers:** Housing providers would continue to be required to pay relocation fees when terminating tenants without cause and cannot serve no-cause evictions on Chapter 5 Tenants. Relocation fees may prevent housing providers from evicting problem tenants not subject to just-cause eviction, or prove costly for recovering use of their units.
    - **Benefits to tenants:** Tenants would continue to be eligible for payment of relocation fees, which ensures some financial relief for Chapter 6 Tenants facing no-cause evictions. Chapter 5 Tenants would continue to be protected against just-cause evictions. Also, the current 60-day prior noticing requirement for tenants served with no-cause evictions provides more time than other forms of evictions to prepare to move households.
    - **Disadvantages to tenants:** The continued potential for no-cause evictions may discourage Chapter 6 Tenants from submitting maintenance requests and general complaints to housing providers for fear of retaliatory eviction, and may generally create an unpredictable and unstable housing atmosphere for Chapter 6 Tenants.

    Administrative Considerations: No increase above current levels of City staff time or resources.

2. **Allow no-cause evictions for Chapter 5 and Chapter 6 tenancies, but continue to require relocation fees for no-cause evictions:**
    - **Benefits to housing providers:** Allowing no-cause evictions for Chapter 5 tenancies in addition to Chapter 6 tenancies would extend housing providers' ability to evict any month-to-month tenant without the obstacle or expense of a court or other cumbersome administrative process. This policy would contribute to regulatory consistency across Chapter 5 and Chapter 6.
    - **Disadvantages to housing providers:** Housing providers would be required to pay relocation fees to Chapter 5 Tenants in the case of no-cause evictions.

[26] The United States Conference of Mayors, *Hunger and Homelessness Survey: A Status Report on Hunger and Homelessness in America's Cities*, December 2013.

- **Benefits to tenants:** There are little to no benefits to tenants, except that Chapter 5 Tenants would become eligible for relocation fees for no-cause evictions.
- **Disadvantages to tenants:** The potential for no-cause evictions may discourage Chapter 5 and Chapter 6 Tenants from submitting maintenance requests and general complaints to housing providers for fear of retaliatory eviction, and may generally create an unpredictable and unstable housing atmosphere for residents of rent stabilized units. This option eliminates eviction protection for Chapter 5 Tenants.

Administrative Considerations: Potentially some increase in City staff time or other resources to mediate disputes about no-cause Chapter 5 evictions, which are currently prohibited.

3. **Expand eviction protections for families and educators residing in Chapter 5 and Chapter 6 rent regulated units:** Under this scenario, no-cause evictions and no-fault evictions would not be allowed during the school year for any rent regulated unit in which children and educators reside.
    - **Benefits to housing providers:** Housing providers would retain the ability to evict tenants from these units during summer months when school is not in session. They would also retain the ability to evict tenants for at-fault reasons, including non-payment of rent and nuisance behavior.
    - **Disadvantages to housing providers:** This option could limit housing providers' ability to evict tenants at specified times of the year.
    - **Benefits to tenants:** This option would increase stability for all families in Beverly Hills by preventing the displacement of teachers mid-year, and in particular, would protect students living in rent regulated units by reducing absenteeism or mid-year school enrollment change.
    - **Disadvantages to tenants:** Tenants would not be protected from evictions during the summer months and they would still be subject to certain types of just-cause evictions.

    Administrative Considerations: Some increase in City staff time or other resources to draft and support enactment of the ordinance, and potentially to monitor and mediate any disputes about such evictions.

4. **Enact a Just-Cause Ordinance for Chapter 6 Tenants and eliminate no-cause evictions for all units covered under the RSO:**
    - **Benefits to housing providers:** There are little to no benefits to housing providers, other than potentially creating more certainty in the eviction process, possibly reducing some housing provider-tenant conflicts associated with involuntary evictions, and eliminating any need to apply different standards for Chapter 5 and Chapter 6 tenants in the same building.
    - **Disadvantages to housing providers:** Without a no-cause option for housing providers, eviction processes could be costly, time-consuming, and an administratively cumbersome legal process, potentially involving third parties.
    - **Benefits to tenants:** A Just-Cause Ordinance would create more security of tenure for Chapter 6 Tenants.
    - **Disadvantages to tenants:** There are little to no disadvantages to tenants, although housing providers may be more inclined to pursue other just-cause means of evicting tenants, such as invoking the Ellis Act to go out of the rental business.

Administrative Considerations: Additional staff time or other resources to research, draft and advise City Council about the enactment of a new Just-Cause Ordinance. Also, potential for some savings over current costs to monitor and mediate no-cause evictions that would no longer be permitted. Other costs or savings would depend on how the Ordinance's administrative procedures are drafted.

5. **Enact a Just-Cause Ordinance for all rental units in the City:**
    - **Benefits to housing providers:** This would create a single set of just-cause eviction requirements for all housing providers, preventing a two-tier system that is only restrictive of housing providers of rent regulated units.
    - **Disadvantages to housing providers:** Without a no-cause option for housing providers, eviction processes could be costly, time-consuming, and an administratively cumbersome legal process, potentially involving third parties.
    - **Benefits to tenants:** This option would likely decrease the prevalence of evictions across the City, protecting tenants from capricious evictions.
    - **Disadvantages to tenants:** There are little to no disadvantages to tenants, although housing providers may be more inclined to pursue other just-cause means of evicting tenants, such as invoking the Ellis Act to go out of the rental business.

    Administrative Considerations: Additional staff time to research, draft and advise City Council about the enactment of a new Just-Cause Ordinance, and to monitor and enforce the Ordinance. Other costs or savings would depend on how the Ordinance's administrative procedures are drafted.

HR&A ADVISORS, INC.
RENT INCREASE APPLICATION PROCESS POLICIES IN THE BEVERLY HILLS RENT STABILIZATION CONTEXT

HR&A Analyze. Advise. Act.

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DRAFT MEMORANDUM

To:	Honorable Mayor and Council, City of Beverly Hills
From:	HR&A Advisors, Inc.
Date:	July 26, 2018
Re:	Rent Increase Application Process Policies in the Beverly Hills Rent Stabilization Context

The City of Beverly Hills (the "City" or "Beverly Hills") retained HR&A Advisors, Inc. ("HR&A") to provide independent research and analysis about seven policy issues related to recently enacted changes to the City's Rent Stabilization Ordinance (the "RSO").[1] This Issue Paper addresses whether, and if so how, the City Council might consider amending the RSO or other sections of the City's Municipal Code to change the procedures for the rent increase applications. The term "rent increase application process" (the "application process") refers to the process by which a housing provider can petition to adjust the maximum allowable rent for a rent stabilized unit.

The Issue Paper begins with a general statement about the issue as it has arisen in the context of the RSO, describes the City's current policies and procedures on the application process, highlights positions about this subject that were mentioned in public discussions about the RSO Amendments, and summarizes how this issue is addressed by 13 other California cities with rent regulation, based on a review of their ordinances and regulations and through discussions with several of those cities' representatives. Based on the information provided on this topic, the Issue Paper concludes with a set of plausible policy options for City Council, City staff, and public consideration.

Statement of the Issue

Rent increase application processes specifying how housing providers can apply for a rent increase above the maximum annual increase permitted by the RSO are included in Chapter 5[2] and Chapter 6.[3] The application process can also be used by Chapter 5 Tenants seeking to challenge a rent increase above the maximum annual increase. Chapter 6 Tenants may choose to participate in the hearing process on the housing provider's application, but cannot independently challenge a rent increase or apply for a decrease.

[1] Ordinance Number 17-O-2729, adopted in April of 2017 (the "RSO Amendments"). The City's Rent Stabilization Ordinance (the "RSO") regulations are included in Beverly Hills Municipal Code ("BHMC") Title 4, Chapter 5 ("Chapter 5") and Chapter 6 ("Chapter 6"). Tenants residing in RSO units subject to regulation under Chapter 5 are hereinafter referred to as "Chapter 5 tenants;" and tenants residing in RSO units subject to regulation under Chapter 6 are hereinafter referred to as "Chapter 6 tenants." Owners of RSO units subject to regulation under Chapter 5 are hereinafter referred to as "Chapter 5 housing providers," and Owners of RSO units subject to regulation under Chapter 6 are hereinafter referred to as "Chapter 6 housing providers." Units subject to Chapter 5 and units subject to Chapter 6 can be located in the same apartment building.

[2] BHMC, Title 4, Chapter 5, Article 3, Section 4-5-401 and 4-5-402

[3] BHMC, Title 4, Chapter 6, Article 3, Section 4-6-11

Rent increase application processes are required in jurisdictions with rent regulation because the courts have determined that the federal and state constitutions require that rent regulation programs allow property owners to earn a "fair return," including those instances in which a housing provider alleges that the annual adjustment formula does not enable the housing provider to do so.[4] Each jurisdiction determines how to define and meet this standard, considering a long line of state and federal court decisions on this issue, which have sometimes been in conflict. As a result, cities with rent regulations utilize different standards and processes for determining how to evaluate housing provider requests for rent increases that exceed otherwise allowable annual rents and/or petitions by tenants to reduce rents due to reductions in housing services or other specified reasons. In most cases, however, enabling housing providers to maintain positive Net Operating Income (i.e., effective annual gross income minus annual operating expenses) year-over-year relative to a specified base year, is the prevailing standard of "fair return" in a rent regulation context.[5]

The Current Beverly Hills Context

Prior to the RSO Amendments, the RSO included a rent increase application process for rental disputes in Chapter 5 tenancies that will be determined by a hearing officer designated by the City Manager.[6] According to this section, a hearing officer has the power and authority to receive applications from housing providers for special rent increases above those permitted by Chapter 5, based on hardship or property tax increases, to hear such matters, and to render binding decisions in such matters.

Per Chapter 5, the hearing officer may approve any such application when the hearing officer determines that such relief is necessary in order to:

1. Implement the purposes of Chapter 5 and to protect the public health and welfare, with particular reference to protecting the occupants of apartment units from unreasonable rent increases, while at the same time recognizing the housing provider's need to have the rent be sufficient to cover maintenance and the costs of operation of the building, and encouraging capital improvements; or
2. Prevent the strict application of this chapter from imposing an undue economic hardship upon a housing provider in a particular case of special circumstances; or
3. Prevent the provisions of this chapter from operating in an unreasonable or illegal manner in the particular circumstances of an applicant

Chapter 5 does not provide a specific formula for computing hardship, and the hardship provisions of Chapter 5 do not guarantee a particular NOI to a Chapter 5 housing provider. This section was unchanged by the RSO Amendments.

Prior to the RSO Amendments, Chapter 6 did not specify a process by which rent increase applications were heard and decided upon. As part of the RSO Amendments, Chapter 6 now includes procedural information on the rent increase application and hearing process, substantive grounds for rent increases, and criteria for determining fair and reasonable return.[7]

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[4] See, for example, *Fisher v. City of Berkeley,* 37 Cal.3d 644, 679-686 (1981).

[5] The concept of "fair return" and how it has been interpreted by the courts in a rent regulation context has been analyzed in detail by Dr. Kenneth Baar, a lawyer and recognized expert on the subject. See Attachment A of HR&A's Maximum Annual Rent Increase Issue Paper.

[6] BHMC, Title 4, Chapter 5, Article 3, Section 4-5-401

[7] BHMC, Title 4, Chapter 6, Section 4-6-11

Under Chapter 6, a housing provider may file a rent increase application with the City for all rental units in the housing provider's apartment building to achieve a just and reasonable return based on "net operating income principles (NOI principles)."[8] Net operating income is a calculation used to analyze real estate investments that generate income and equals all revenue from the property minus all reasonable and necessary operating expenses. Non-operating expenses such as debt service and depreciation are generally not included in NOI. The City's NOI principles set forth a standard for determining whether a housing provider is receiving a fair return based on a comparison of current year NOI with "base year," or NOI as of 2016.

In the Chapter 6 rent increase application process, after the review of an application and a hearing attended by both parties, a hearing officer determines whether a housing provider is receiving a reasonable rate of return. If the housing provider has demonstrated an increase in specified expenses exceeding the maximum allowable increase, they will be granted a higher rent level to maintain the same rate of return as they did in the base year. If the housing provider has made capital improvements or plans to make capital improvements started during the current year pursuant to the RSO, they may be amortized and passed through to the tenant as appropriate.[9]

Chapter 6 also includes a "savings clause," that provides a basis for a hearing officer to receive relevant evidence demonstrating that a housing provider is not receiving a just and reasonable return under the provisions of the NOI formula, so that the application of the NOI formula may be modified to provide a just and reasonable return to the housing provider.

While a hearing officer is the authority adjudicating the application process in both Chapter 5 and Chapter 6, Chapter 5 states that the Department of Community Development[10] may provide a recommendation on decisions made by the hearing officer that were appealed only in the case that the hearing officer received incorrect information or the information was erroneous.[11] In the Chapter 6 application process, the hearing officer is the single authority and any appeals of his or her decision must be pursued through the courts. The steps in the Chapter 6 application process are illustrated in Figure 1.

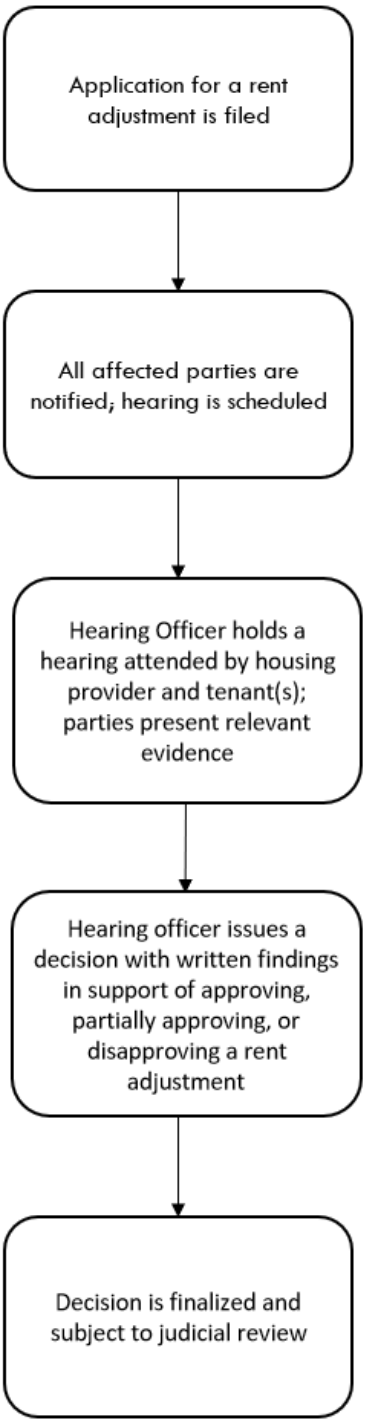
[8] Ibid.

[9] Ibid.

[10] Beverly Hills Municipal Code refers to the Department of Building and Safety, which is now the Department of Community Development. There has been a department name change since the Code was adopted.

[11] BHMC Title 4, Chapter 5, Section 4-5-401(c)

Figure 1: Summary of Beverly Hills Chapter 6 Rent Increase Application Process



Source: HR&A Advisors, Inc. and the City of Beverly Hills

To date, Beverly Hills has received a total of six petitions through the RSO application process. All six petitions related to Chapter 5 tenancies and were processed prior to the RSO Amendments between 1999 and 2014. Four of the six applicants were housing providers petitioning for rent increase due to hardship; the other two applicants were tenants petitioning for the elimination or reduction of capital expenditure surcharges passed through to them by owners. All six petitions were denied by the hearing officer following a hearing and evaluation of evidence and testimony.

HR&A review of the files on these cases indicates that each of the applications was generally denied due to insufficient or inconsistent testimony, particularly the failure to provide evidence in support of claims. For the rent increase petitions, a critical deciding factor for denial was the distinction between the impact of voluntary, informed decisions made by a housing provider to purchase and finance an unprofitable property, and petitioner allegations about the impact of extraordinary expenses that could not have been foreseen at the time of purchase. While all of these petitions were denied, after review of the housing provider's income and expenses the hearing officer generally suggested that housing providers begin to apply maximum allowable rent increases to all units on the property, and for any units with capital expenditures that had not been passed through, to require the permissible monthly surcharge amount after proper noticing to tenants.

For the two petitions seeking reductions of capital improvement surcharges, the hearing officer's evaluation focused primarily on distinctions between capital improvements and normal repair and maintenance, and identification of the degree to which an improvement directly benefited the applicant's unit as compared with other units on the property. While both petitions regarding capital improvement surcharge reductions were denied, in one of the cases the surcharge amount was lowered slightly after review of the nature of the relevant improvements.

Facilitated Dialogue Sessions

During a series of professionally-facilitated dialogue sessions between Beverly Hills housing providers and tenants living in buildings subject to the RSO following adoption of the RSO Amendments, tenant representatives stated that the new Chapter 6 rent increase application process greatly favors the housing providers by:

- Benchmarking profits relative to 2016 which was a high-water mark since the economic crisis (and a period that City Council has characterized as rising rents);
- Allowing the housing provider to include expenses that do not distinguish between maintenance and capital improvements that may be fair reason for a rent increase; and
- Giving housing providers a get-out-of-jail-free card in the guise of a "savings-clause."[12]

Further, tenant representatives stated that:

- No rent increase should be approved unless the housing provider maintains the rental property in acceptable condition; and
- The ordinance does not properly distinguish improvements from maintenance, and that only the cost of improvements, not maintenance, should be passed through to tenants. For example, the RSO classifies such items as replacement flooring and roofing as "improvements" when they merely return

[12] Beverly Hills Tenants Committee, 31-August-2017

a property to a prior state. The RSO should clarify that replacement of base amenities does not constitute improvement.[13]

In conversations with City staff, housing provider representatives generally have expressed the following positions:

- The process requires too much paperwork and is overly burdensome; and
- The process requires too much disclosure of sensitive information.

A Rent Mediation Board to hear appeals was raised by housing providers and tenants. Both tenants and housing providers agreed that the City should convene a "mediation board" where matters can be heard and discussed to improve communication between housing providers and tenants. A staff report to City Council on this topic raised issues for the City to consider with regards to a Rent Mediation Board, including who would be represented on the committee, whether such representatives would be revolving in nature, and whether mediation sessions would be public or private.[14]

Comparison with Other Cities in California

Each of the 14 California cities with rent regulation programs, including Beverly Hills, has a rent increase application process for individual rent increases allowing housing providers to petition for rent increases and tenants to challenge rent increases, but the cities differ both in the details of the application review process and how fair return is defined.

Decision Maker Authority

Beverly Hills is unique among the cities in having a hearing officer designated by the City Manager as the only decision maker, for rent applications under both Chapter 5 and Chapter 6. The Chapter 6 application process is also unique in that the first decision made by the hearing officer is the binding final decision, only subject to appeal through the courts. Though the Chapter 5 application process may also involve a recommendation from the Department of Community Development as part of an appeal to the hearing officer's decision in the case that erroneous information was used during the initial hearing, the hearing officer is ultimately the single authority responsible for deciding the outcome of the process.[15]

Eleven of the other cities have, at a minimum, both a hearing officer who is responsible for issuing the initial decision, and a rent control board responsible for voting to affirm or modify the decision made by the hearing officer in the case of an appeal, as shown in Figure 2.

Some cities have additional authorities involved in the application process, such as a conciliator, a mediator, an attorney, or a department director.

[13] City Council Agenda Report with Summary of Facilitated Dialogues, 5-September-2017

[14] City Council Agenda Report with Summary of Facilitated Dialogues, 5-September-2017

[15] BHMC Title 4, Chapter 5, Section 4-5-401(c)

Figure 2: Comparison of Authorities Involved in the Rent Increase Application Process

City	Hearing Officer/ Arbitrator	Mediator	Department Director	Rent Control Board
Beverly Hills Ch. 5	✓			
Beverly Hills Ch. 6	✓			
Berkeley	✓			✓
East Palo Alto	✓			✓
Hayward	✓	✓	✓	
Los Angeles	✓			✓
Los Gatos	✓	✓		
Mountain View	✓			✓
Oakland	✓	✓	✓	✓
Palm Springs	✓			✓
Richmond	✓			✓
San Jose	✓	✓	✓	✓
San Francisco	✓	✓		✓
Santa Monica	✓			✓
West Hollywood	✓			✓
Percentage	**100%**	**36%**	**21%**	**79%**

Source: HR&A Advisors, Inc. and the individual cities

Mediation

Five of the other cities (Los Gatos, Hayward, Oakland, San Jose, and San Francisco) offer conciliation and/or mediation services as a first step after an application is filed for rent increase. In the conciliation process, a trained conciliator corresponds with the housing provider and affected tenants by phone or mail in attempts to reach an agreement about a rent adjustment. In the mediation process, a trained mediator facilitates an in-person conversation with the housing provider and affected tenants in attempt to reach an agreement. Conciliators and mediators are individuals employed by cities and trained in mediating disputes, as well as in rent regulation law and the economics of rent regulation.

The City of San Francisco Municipal Code states that parties often prefer mediation over formal arbitration because it is more flexible and allows for results that might not be permissible should a decision be reached by arbitration. Further, mediation often helps parties by providing guidance for dealing with future disputes and by its less confrontational nature can produce more mutually beneficial results than arbitration.

Another advantage of mediation is that decisions can sometimes be reached more quickly, resulting in an immediate and binding agreement that is not subject to an appeal. However, if mediation is unsuccessful, it can delay the process considerably.

Rent Control Boards

Ten cities (West Hollywood, Santa Monica, San Francisco, Richmond, Palm Springs, Oakland, Mountain View, Los Angeles, East Palo Alto, and Berkeley) have rent control boards[16] that, among many other administrative responsibilities, govern the rent increase application process, generally by hearing appeals from decisions of hearing officers. Like hearing officers, rent control boards are typically authorized to increase the maximum amount of rent otherwise permitted to be charged by a housing provider in those cases where the rent control board finds that the application of the local rent regulations, apart from such authorized increase, prevent or would prevent a housing provider from receiving a just and reasonable return.

Rent control boards are either appointed by the local City Council or Mayor, or elected by local voters. The Santa Monica and Berkeley rent control boards are elected bodies. Rent control board members are generally city residents who have been deemed neutral parties and who do not own property subject to the city's rent regulations. Some rent control boards hold *de novo* hearings after a hearing officer's decision is appealed (i.e., hears the entire case from the beginning), but more commonly reviews a report from the initial hearing and accompanying documentation to make a final decision to uphold, modify, or remand the matter back to the hearing officer .

While hearing officers are generally either attorneys or professionals who are familiar with the legal standards that must be applied in rendering such decisions, rent control board members must be trained to ensure compliance with the relevant legal principles so their decisions can withstand judicial scrutiny.

Comparison of Rent Increase Application Process Steps

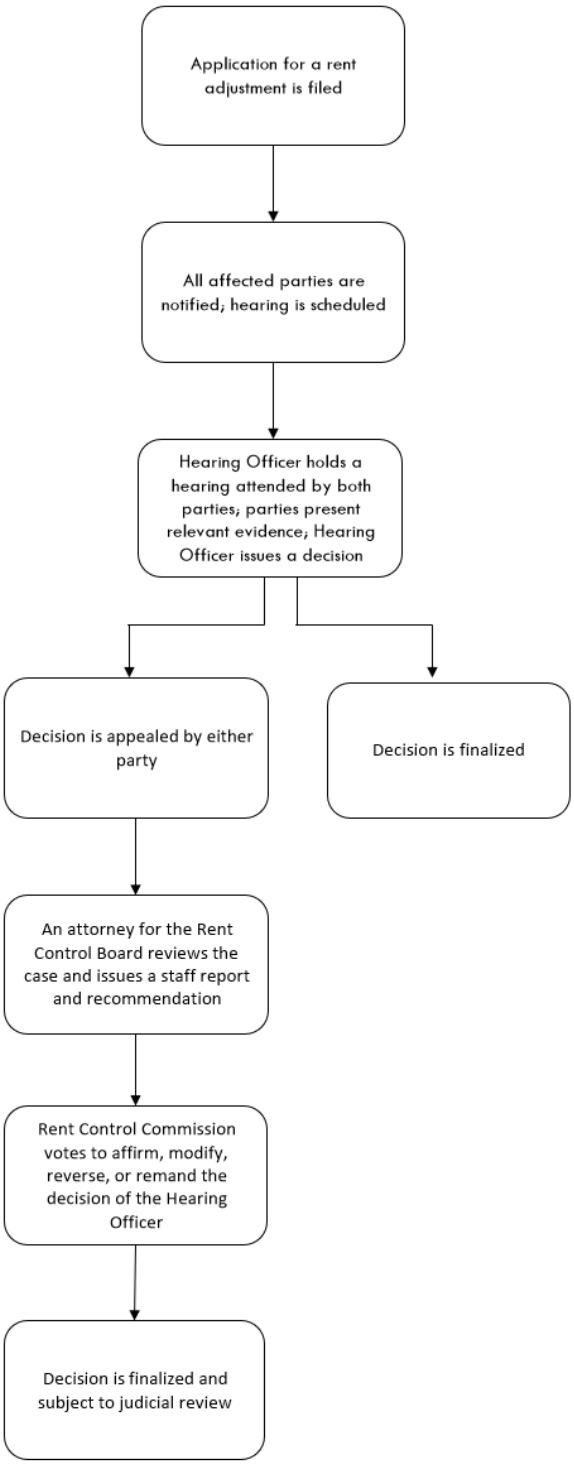
Each of the fourteen cities has a distinct rent increase application process, with different steps leading to approval or denial of a rent increase petition. The steps involved in the Beverly Hills Chapter 6 application process were illustrated above in Figure 1, and the application processes of two cities with different approaches are illustrated below in Figure 3 and Figure 4.

Figure 3 illustrates the Santa Monica application process, which differs from Beverly Hills in its inclusion of additional authorities and how responses to appeals are handled. Like Beverly Hills Chapter 6, Santa Monica's application process begins with a hearing, after which a hearing officer issues a decision. However, in Santa Monica, if a hearing officer's decision is appealed, an attorney for the Rent Control Board reviews the case and issues a staff report and recommendation to the Santa Monica Rent Control Board. The Rent Control Board then votes on a decision, which is finalized and subject to judicial review.

Figure 4 illustrates the Oakland application process, which differs from Beverly Hills in its inclusion of additional authorities, mediation services, and the response to appeals. Oakland's application process begins with the review of a petition by an administrative analyst, who decides whether to assign the case to a mediator or a hearing officer, or to issue a decision if there is a clear outcome that does not require a hearing. If mediation does not conclude in a mutually agreed upon decision, or if the administrative analyst's decision is appealed, the case goes to a hearing, after which a hearing officer issues a decision. If the hearing officer's decision is appealed, a second hearing is held by the Housing Residential Rent and Relocation Board. This board then votes on a decision, which is finalized and subject to judicial review.

[16] As used here, "rent control board" refers to any committee, commission, or board, appointed or elected, that convenes to decide the outcomes of rent-level increase cases under a rent-stabilization ordinance.

Figure 3: Summary of Santa Monica Rent Increase Application Process (Hearing Officer, Attorney for Rent Control Board, Rent Control Board)



Source: HR&A Advisors, Inc. and the City of Santa Monica

Figure 4: Summary of Oakland Rent Increase Application Process (Administrative Analyst, Mediator, Hearing Officer, Rent Board)

Source: HR&A Advisors, Inc. and the City of Oakland

Rent Increase Considerations

The following are the key considerations that typically arise in the design and implementation of rent application processes.

Base Year

The rent increase application processes in 10 of the 14 cities, including Beverly Hills Chapter 6, explicitly define fair return as the maintenance of housing provider NOI over time, beginning with a base year determined by each city. Cities may choose any base year. Typically, a base year is chosen that immediately predates the notice of the possible consideration of a rent control ordinance by local government, so that rents have not been increased in anticipation of the adoption of the ordinance. The years that these cities use as base years for maintenance of NOI range from 1977 in Los Angeles to 2016 in Beverly Hills for Chapter 6 tenancies, as shown in Figure 5.

Figure 5: Comparison of Base Years for NOI

City	Base Year for NOI
Beverly Hills Ch. 6	2016
Berkeley	1979
East Palo Alto	1985
Los Angeles	1977
Mountain View	2015
Oakland	2014
San Jose	2014
San Francisco	2002
Santa Monica	1978
West Hollywood	1983

Source: HR&A Advisors, Inc. and the individual cities

A city may assign different base years according to the year in which tenancies began. San Francisco, for example, assigns a base year of 2002 for any tenancies existing as of 2003, and the year preceding the move-in date for tenancies which began after 2003. Additionally, cities with earlier base years, such as Los Angeles, specify that the "base year is either 1977 or the earliest year for which a property's financial records are available."[17]

Operating Expense Categories

Though four of the 14 cities do not specify that fair return is a comparison of current year NOI to a base year NOI, each of the cities evaluates longitudinal patterns in housing provider operating expenses when considering an individual rent increase and specify which expense categories are relevant to rent increase determinations through the rent increase application process. All of the cities consider extraordinary, unavoidable increases in operating and maintenance expenses, including property taxes, utilities not passed through to tenants, and other managerial and legal expenses. As shown in Figure 6, cities with rent

[17] HCIDLA, What is A Just and Reasonable Rent Increase?; http://hcidla.lacity.org/blog/what-just-and-reasonable-rent-increase

regulations differ as to whether they consider debt service payments as a component of a housing provider's expenses when determining fair return, and in how they address capital improvement costs.

Figure 6: Comparison of Housing Provider Expenses Considered in Rent Increase Application Process, 2018

City	Operations and Maintenance Increases	Debt Service Increases	Capital Improvements	Capital Improvements Only if Needed to Bring Building Up to Code
Beverly Hills Ch. 5	✓		✓	
Beverly Hills Ch. 6	✓		✓	
Berkeley	✓			✓
East Palo Alto	✓		✓	
Hayward	✓	✓	✓	
Los Angeles	✓	✓	✓	
Los Gatos	✓	✓	✓	
Mountain View	✓			✓
Oakland	✓		✓	
Palm Springs	✓		✓	
Richmond	✓			✓
San Jose	✓		✓	
San Francisco	✓	✓	✓	
Santa Monica	✓		✓	
West Hollywood	✓		✓	
Percentage	**100%**	**29%**	**79%**	**21%**

Source: HR&A Advisors, Inc. and the individual cities

Debt Service Costs

Four cities (Hayward, Los Angeles, Los Gatos, and San Francisco) consider increased cost of debt service payments a relevant expense factor when examining housing provider annual operating expenses in the rent increase application process. Costs associated with debt service may include mortgage interest and principal payments and other expenses associated with obtaining debt, including but not limited to appraisal and title insurance costs. Cities sometimes limit the percentage of total debt service costs allowed for a rent increase, or hearing officers may determine the amount permitted as a rent increase using their own criteria.

Some cities that consider debt service only consider this expense if a mortgage began before a certain date. For example, Los Angeles factors debt service expense into rent increase determinations only when the debt service relates to financing obtained prior to June 1, 1978, and if debt service expenses contain either a balloon payment or a variable rate provision. With the elapsed time, very few tenancies probably still meet these criteria, and remaining costs related to these mortgages would likely be nominal.

Capital Improvements

The cities also differ in whether they require housing providers to use the rent increase application process to pass through capital improvements. While some of the cities require housing providers to use the rent

increase application process to pass through capital improvements to be included as part of a rent increase, like Beverly Hills Chapter 6, other cities allow housing providers to add capital improvements surcharges pursuant to local guidelines at the time of an annual rent increase, like Beverly Hills Chapter 5. All cities that allow housing providers to apply capital improvement surcharges without using the application process also allow tenants to use the application process to challenge rent surcharges due to capital improvements.

The cities also differ in whether they allow housing providers to apply for pass-throughs for all capital improvements or only for capital improvements needed to bring a property into code compliance. Cities may have specific pass-through guidelines for different types of capital improvements, such as those that require a permit from the Department of Community Development and those that do not, or in the case of Beverly Hills Chapter 6, utilize an amortization schedule by the type of capital improvement made.

Other Considerations in the Rent Increase Application Process

While all 14 cities evaluate housing provider annual operating expenses over time, many cities may consider factors extraneous to housing provider financials. Nine of the cities (Berkeley, Hayward, Los Angeles, Los Gatos, Mountain View, Palm Springs, Richmond, San Francisco, and Santa Monica) also consider peripheral information when determining appropriate rent increases. Common factors considered outside of a housing provider's income and expenses include:

- Rent-level increase history;
- Market value of similar units;
- Increase or decrease in housing services provided;
- Whether property is a short-term or long-term investment; and
- Physical condition of rental unit (subject to inspection by a hearing officer or an independent inspector sent on behalf of a hearing officer)

These additional considerations suggest that some cities take a broader view of fair return and a more holistic approach to the rent increase application process. While all cities are required to meet fair return principles, cities may determine the fair amount of permissible rent increase using qualitative or contextual factors in addition to revenues and expenses for a property.

Policy Options for Beverly Hills

Based on the foregoing information and data, HR&A suggests that there are at least five plausible policy options that the City Council, City staff, and the public could consider when determining whether, and if so how, to address the rent increase application process. Some of these options concern the factors that could be considered in the application process, while some concern the process itself, and therefore there could also be some combinations of these options.

1. **No Policy Change:** Under this option, the rent increase application process for Chapter 5 and Chapter 6 would continue to be adjudicated by a hearing officer and determination made principally upon evaluation of housing provider annual net operating income data. Capital expenditures can be applied as surcharges without the application process for Chapter 5 tenancies, but for Chapter 6 tenancies are factors considered as part of the rent increase application process.
    - **Benefits to housing providers:** The application process for Chapter 5 and Chapter 6 would continue to be based on a relatively objective, formulaic decision-making process, so that if a housing provider demonstrates sufficient evidence of hardship, or is not achieving a fair return, a rent increase would be granted. Chapter 5 housing providers maintain the ability to apply capital expenditure surcharges without using the application process.
    - **Disadvantages to housing providers:** The application processes for Chapter 5 and Chapter 6 currently do not consider debt service payments or any related acquisition costs in determining whether a housing provider is achieving fair return. Housing providers paying off debt service on a property subject to the RSO may be operating at a loss that is not recognized by the City under the current application process, which could theoretically lead to their removal of the structure from the rental market, or difficulty in attracting future buyers.
    - **Benefits to tenants:** Chapter 5 tenants maintain the ability to challenge rent increases, and both Chapter 5 and Chapter 6 tenants maintain the ability to participate in the application review process. Chapter 6 tenants are protected from capital expenditure surcharges except those that have been approved by a hearing officer.
    - **Disadvantages to tenants:** Because the application process is principally based on housing provider financials, factors affecting the tenant such as the physical condition of the unit are not explicit criteria.

    Administrative Considerations: Given the very low number of Chapter 5 rent increase applications to date, and no change in current procedures, no increase in City costs would be expected. However, use of the rent application process could increase as a result of the change in the maximum annual rent increase formula, increasing City costs for hearing officers.

2. **Implement a Uniform Rent Increase Application Process for Chapter 5 and Chapter 6:** Under this option, there are two sub-options, which are not mutually exclusive.
    a) The current application process for Chapter 6 could be applied to Chapter 5. Maintenance of housing provider NOI would be the fair return standard used for all Chapter 5 and Chapter 6 rent increase petitions. Chapter 5 housing providers would no longer be able to apply capital expenditure surcharges by right and all housing providers' capital expenditures would be factors considered as part of a general rent increase application process.

b) The default pass-through allowances for Chapter 5 could be applied to Chapter 6. Capital expenditure pass-throughs could be applied according to RSO guidelines, and would only be subject to review if challenged by a tenant through the application process.

- **Benefits to housing providers:** Implementing a single application process for both Chapter 5 and Chapter 6 would simplify and streamline the process, potentially making the process easier for housing providers to understand and navigate, particularly when their buildings include both Chapter 5 and Chapter 6 Tenants. Additionally, if the Chapter 5 pass-through procedures were applied to Chapter 6, it could decrease the need for housing providers to use to the application process.
- **Disadvantages to housing providers:** If the Chapter 6 application process is applied to Chapter 5, housing providers could no longer apply capital expenditure surcharges by right; they would instead need to pursue a general rent increase through the application process.
- **Benefits to tenants:** Implementing a single application process for both Chapter 5 and Chapter 6 would simplify and streamline the process, potentially making the process easier for tenants to understand and navigate. The standard used to determine whether a rent increase is justified would be clearer and more formulaic.
- **Disadvantages to tenants:** The considerations for the rent increase application process would continue to be based on factors unrelated to the quality of the housing provided to the tenant.

Administrative Considerations: Cost implications would depend on which sub-option were selected. Extending formula capital expenditure surcharges now available under Chapter 5 to Chapter 6 Tenants could reduce costs; conversely, applying the Chapter 6 rent application requirement for capital expenditures to Chapter 5 could increase administrative costs, but probably not by much considering the relatively small number of Chapter 5 Tenants. Minor costs would be incurred for drafting and supporting enactment of the RSO changes.

3. **Create a Rent Control Board to Respond to Appeals of Hearing Officer Decisions:**
    - **Benefits to housing providers:** A Rent Control Board would increase the number of decision-makers in the application process, allowing the hearing officer's decision to be reviewed by another group.
    - **Disadvantages to housing providers:** Introducing a Rent Control Board would likely prolong the application process, as the Rent Control Board would require time to either hold a *de novo* or narrower appeal topic hearing and reach a decision.
    - **Benefits to tenants:** A Rent Control Board provides an additional forum for tenant testimony and would increase the number of decision-makers involved in the application process.
    - **Disadvantages to tenants:** Introducing a Rent Control Board would likely prolong the application process, as the Rent Control Board would require time to either hold a de novo or narrower appeal topic hearing and reach a decision.

    Administrative Considerations: This provision would require significant City time and other resources, both to establish the Rent Control Board, train board members in rendering legal decisions and staffing the meetings, although fees charged for use of the procedures could offset some of the cost.

There would also be costs associated with researching, drafting and supporting enactment of the new procedures.

4. **Provide Optional Mediation Services in Advance of the Hearing by a Hearing Officer:**
    - **Benefits to housing providers:** Mediation is more likely to end in a win-win agreement for housing providers and tenants than a hearing decision. As mediation is intended to improve communication between housing providers and tenants, mediation could lead to improved housing provider-tenant relations. The mediation process can also occur more quickly under the current application process timeline.
    - **Disadvantages to housing providers:** Because mediation services would be optional, the tenant could opt out of mediation, causing the petition to go directly to a hearing officer.
    - **Benefits to tenants:** Mediation would invite the tenant's point of view and incorporate factors external to housing provider financials. As mediation is intended to improve communication between housing providers and tenants, this could lead to improved housing provider-tenant relations. The mediation process can also occur more quickly than the current application process timeline.
    - **Disadvantages to tenants:** Because mediation services would be optional, the housing provider could opt out of mediation, causing the petition to go directly to a hearing officer.

    Administrative Considerations: This provision would require additional City staff or other resources for mediation services, although fees charged for use of the procedures could offset some of the cost. There would also be costs associated with researching, drafting and supporting enactment of the new procedures.

5. **Expand the Range of Factors Under Consideration in Rent Increase Application Process:** Under this option, considerations made when evaluating a rent increase petition would be expanded to include factors other than a housing provider's financials. Additional factors under consideration might include: the market-value of similar units, changes in housing services provided, or the physical condition of a rental unit as assessed by the hearing officer.
    - **Benefits to housing providers:** If a housing provider has made improvements to a unit or increased housing services provided, the quality and not just the cost implications of those changes would be accounted for in the application process and fair return determination.
    - **Disadvantages to housing providers:** Housing providers may be disadvantaged if the conditions of the unit that is the subject of a petition are not up to the standard of the rent increase that they are seeking.
    - **Benefits to tenants:** Expanding the factors under consideration in the application process would benefit tenants by incorporating factors that impact them directly. This approach could require a formal inspection to distinguish between capital improvements and normal maintenance, which was a concern expressed by the tenants' group.
    - **Disadvantages to tenants:** There would be little to no inherent disadvantages to tenants.

    Administrative Considerations: This provision would potentially require additional City staff time or other resources, for example, by including a formal inspection of units subject to a rent increase in the process, and hearing time needed to account for the new considerations. New or revised rent

application appeal review fees could offset some of this cost. There would also be costs associated with researching, drafting and supporting enactment of the new procedures.

HR&A ADVISORS, INC.
EXPLANATION OF THE ELLIS ACT AND INTERACTIONS WITH THE RENT STABILIZATION ORDINANCE

HR&A Analyze. Advise. Act.

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DRAFT MEMORANDUM

To:	Honorable Mayor and City Council, City of Beverly Hills
From:	HR&A Advisors, Inc.
Date:	July 26, 2018
Re:	Explanation of the Ellis Act and Interactions with the Rent Stabilization Ordinance

The City of Beverly Hills (the "City" or "Beverly Hills") retained HR&A Advisors, Inc. ("HR&A") to provide independent research and analysis about seven policy issues related to recently enacted changes to the City's Rent Stabilization Ordinance (the "RSO").[1] This Issue Paper explains the Ellis Act[2] (copy included as Attachment A), a California ("State") law that allows housing providers to exit the rental market business by evicting tenants (which is a form of "no-fault" eviction[3]) and use the property for a different purpose. The RSO Amendments addresses the Ellis Act only in the context of relocation fees for no-fault eviction of any rent-stabilized tenant, as well as through extended eviction noticing requirements for Chapter 5 tenants subject to Ellis Act evictions. The Issue Paper begins with background information and explanation about the Ellis Act, how the Ellis Act interacts with the RSO, and a summary of how the Ellis Act is addressed by 13 other California cities with rent regulation, based on a review of their ordinances and regulations and through discussions with City representatives. Based on the information provided on this topic, the Issue Paper concludes with a set of plausible policy options for City Council, City staff, and public consideration.

Ellis Act Background and Explanation

The State Legislature adopted the Ellis Act in 1985 to legally enable California housing providers to withdraw their apartments from the rental market, evict their tenants and go out of the apartment rental business. The Ellis Act was passed in response to a 1984 California Supreme Court decision in the case of *Nash v. City of Santa Monica*,[4] which held that the city's requirement that Nash obtain a "removal permit" from the Rent Control Board before evicting tenants and demolishing his apartment building were reasonably related to the City's goal of protecting its scarce rental housing supply, and that Nash had other options for going out of the rental business (e.g., sale to another owner) and would not necessitate tenant evictions..

[1] Ordinance Number 17-O-2729, adopted in April of 2017 (the "RSO Amendments"). The City's Rent Stabilization Ordinance (the "RSO") regulations are included in Beverly Hills Municipal Code ("BHMC") Title 4, Chapter 5 ("Chapter 5") and Chapter 6 ("Chapter 6"). Tenants residing in RSO units subject to regulation under Chapter 5 are hereinafter referred to as "Chapter 5 Tenants;" and Tenants residing in RSO units subject to regulation under Chapter 6 are hereinafter referred to as "Chapter 6 Tenants."

[2] California Government Code Sections 7060-7060.7.

[3] The term "no-fault" eviction refers to an involuntary termination of tenancy for other than "at-fault" reasons established under State law or the terms of the RSO (e.g., failure to pay lawful rent, lease terms violations, maintenance of a nuisance, illegal uses, failure to execute lease, refusal to provide unit access, and unapproved subtenants).

[4] 37 Cal. 3d 97 (1984).

Under the Ellis Act, housing providers seeking to withdraw rental units from the market must comply with certain procedures, including filing a formal memorandum of intent with the County Recorder and providing tenants with at least 120 days of advance notice, or a year if tenants are senior citizens or disabled, of the proposed eviction. Additionally, housing providers utilizing the Ellis Act must evict all tenants within the respective property and cannot evict only selected tenants. Once all tenants have been evicted, a housing provider may demolish the subject building;[5] convert it to condominiums, commercial uses, and/or non-rental residential uses; or use it for family occupancy. Within five years of invoking the Ellis Act, a housing provider may only re-rent units that were vacated at the same rent the evicted tenant paid at the time of eviction.

There is currently legislation under consideration by the State Assembly that, in its current form, would augment some of these restrictions.[6] The proposed changes include increasing the period during which units brought back to market must be re-rented at the rates at the time of eviction from five years to 10 years from the time units are withdrawn, and clarifying that if one unit is brought back to market then all units in that same building must be brought back to market.

Beyond the requirements under State law, the Ellis Act provides flexibility for local jurisdictions to impose additional limitations on the use of the Ellis Act. These options include requiring housing providers to pay relocation fees to affected tenants, mandating a right of first refusal for displaced tenants to move back into units in instances when a property is placed back on the rental market within a given timeframe, and establishing stipulations for conversions to condominiums or other uses, among others.

While the original intent of the Ellis Act was to provide greater flexibility for housing providers to exit the apartment rental business, it is increasingly being used by real estate speculators in strong real estate markets. The Ellis Act effectively provides a legal mechanism for property owners to remove tenants from rent-stabilized buildings, and then capitalize on the current market value of the property and/or the existing building by converting it to uses that are not price-controlled. Studies prepared for the cities of Los Angeles (2009),[7], San Francisco (2014),[8] and Santa Monica (2017),[9] have shown that evictions of rent-stabilized tenants, and the related use of the Ellis Act, increase as property sale prices increase, and typically occur in areas where property values and rents are highest.

As an example of the Ellis Act's impacts on local rent-restricted housing, a study prepared by the City of West Hollywood (2017)[10] shows that 764 units in 203 buildings, nearly five percent of West Hollywood's rent-stabilized units, have been removed from the rental market pursuant to the Ellis Act since 1986, primarily

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[5] Some cities have general requirements that must be followed prior to issuance of a demolition permit for any multifamily building citywide. For example, the City of Santa Monica requires an approved replacement project prior to demolition of multifamily structures or garages. These restrictions are not intended to address the Ellis Act specifically, but necessarily affect Ellis Act evictions.

[6] Assembly Bill 2364 (Bloom and Chiu), February 14, 2018

[7] Economic Roundtable, *Economic Study of the Rent Stabilization Ordinance and the Los Angeles Housing Market,* 2009; http://hcidla.lacity.org/system/files_force/documents/Economic%20Study%20of%20the%20Rent%20Stabilization%202009.pdf?download=1

[8] City and County of San Francisco Board of Supervisors Budget and Legislative Analyst, *Analysis of Profits of Ellis Act Eviction Property Sales,* 2014; https://sfbos.org/Modules/ShowDocument.aspx?documentid=48342

[9] Keyser Marston Associates, *The Ellis Act and Its Effects on Rent-Stabilized Housing in Santa Monica,* 2017; https://www.smgov.net/uploadedFiles/Departments/Rent_Control/About_the_Rent_Control_Board/Staff_Reports/2017/Item%2012A%20Ellis%20Act%20Report.pdf

[10] City of West Hollywood, *2016 Housing Report*, 2016; https://www.weho.org/Home/ShowDocument?id=35012

to make way for new construction or to be redeveloped for single-family residences, although 186 withdrawn units in 68 buildings remain off market and vacant. In Santa Monica, 3,042 units have been withdrawn from the rental market since 1986 pursuant to the Ellis Act, although 836 have been returned to the rental market resulting in a net loss of 2,206 rent-regulated units over that time.[11] More than 20,000 rent-regulated units were removed from the rental market in Los Angeles between 2001 and 2016 through use of the Ellis Act.

The Current Beverly Hills Context

Despite the prevalence of evictions under the Ellis Act in other California cities with rent regulation, it has been used in Beverly Hills to withdraw only three rent-stabilized buildings from the rental market,[12] which is less than one percent of the 1,093 currently rent-stabilized buildings in the City.[13] The infrequent use of the Ellis Act in the City results from the fact that it can now be used only for buildings with Chapter 5 Tenants, which represent a small share of buildings (and about 4% of units) subject to the RSO. Chapter 5 prohibits no-cause evictions and limits no-fault evictions (i.e., Chapter 5 is a form of "just-cause" ordinance), meaning that housing providers must generally invoke the Ellis Act to go out of the rental business through the process of removing units from the housing market. On the other hand, the majority (96%)[14] of the City's rent-stabilized tenants are regulated by Chapter 6, which permits both no-fault and no-cause evictions[15] (i.e., Chapter 6 is not a just-cause ordinance) and therefore housing providers do not need to invoke the Ellis Act to evict tenants and remove units from the housing market.

It is possible that the recent annual rent limitation requirements applicable to Chapter 6 tenants, adopted by the City Council under the RSO Amendments, could cause more housing providers to consider evicting tenants and exiting the apartment business, which as noted above can now be done without utilizing procedures required under the Ellis Act, although doing so would now require payment of relocation fees.

[11] Santa Monica Rent Control Board, *2017 Annual Report*, 2017; https://www.smgov.net/uploadedFiles/Departments/Rent_Control/Reports/Annual_Reports/2017%20Annual%20Report%20FINAL.pdf

[13] Per data provided by City of Beverly Hills code enforcement staff. The RSO Registry file provided to HR&A by the City on March 21, 2018 includes three properties containing a total of 17 units that are recorded as having been built after 1995. Rents for properties constructed after February 1, 1995 cannot be controlled pursuant to Costa Hawkins Act. Therefore, HR&A excluded these three properties and 17 units from the above analysis. The three properties and 17 units that were excluded represent less than one percent of all RSO properties and units, and their exclusion from the analysis is therefore assumed have a *de minimis* impact on cited Chapter 5 building and unit proportions.

[14] Ibid.

[15] No-cause evictions are involuntary terminations of tenancies for which no reason for eviction is stated by the housing provider. This is the subject of a separate HR&A Issue Paper.

Comparison to Other California Cities with Rent Regulation

As shown in Figure 1, Beverly Hills is among 11 of 14 (79%) California cities with residential rent regulation programs that have established measures to regulate Ellis Act evictions, as well as to protect and assist tenants who are subject to Ellis Act and other no-fault evictions.

Figure 1: Summary of California Cities with Ellis Act Mitigation Measures, 2018

City	Have Ellis Act Eviction Mitigation Measures
Beverly Hills (Ch. 5 only)	✓
Berkeley	✓
East Palo Alto	✓
Hayward	
Los Angeles	✓
Los Gatos	
Mountain View	✓
Oakland	✓
Palm Springs	
Richmond	✓
San Jose	✓
San Francisco	✓
Santa Monica	✓
West Hollywood	✓
Percentage	**79%**

Source: HR&A Advisors, Inc. and the individual cities

The 11 cities that regulate Ellis Act evictions require housing providers to pay relocation fees to tenants that experience this category of no-fault eviction, and employ a number of other measures, as shown in Figure 2. These other measures include extending eviction noticing requirements beyond the minimum 120-day notice mandated by State law; placing limitations on the ability for buildings that were vacated pursuant to the Ellis Act to be demolished or converted to condominiums; levying impact fees on rent stabilized units that are demolished or converted; requiring any lost rent stabilized units to be replaced on a one-for-one basis; providing legal assistance or case management for tenants experiencing evictions under the Ellis Act; and offering evicted tenants priority on local affordable housing waitlists.

Figure 2: Ellis Act Mitigation Measures by City, 2018

City	Relocation Fees	Extended Noticing	Demolition Limitation	Condominium Conversion Limitations	Impact Fees	One-for-One Replacement	Legal Assistance/ Case Management	Affordable Housing Waitlist Priority
Beverly Hills (Ch. 5 only)	✓	✓						
Berkeley	✓		✓	✓	✓	✓		
East Palo Alto	✓			✓		✓		
Los Angeles	✓		✓			✓	✓	
Mountain View	✓							
Oakland	✓			✓				
Richmond	✓							
San Jose	✓							
San Francisco	✓			✓	✓		✓	✓
Santa Monica	✓		✓	✓				✓
West Hollywood	✓							✓
Percentage	**100%**	**9%**	**27%**	**45%**	**18%**	**27%**	**18%**	**27%**

Source: HR&A Advisors, Inc. and the individual cities

Besides requiring relocation fees, the most common measure is placing limitations on the conversion of rent stabilized units to condominiums, which five of the 11 (45%) cities have adopted. Cities limit conversions to condominiums in a variety of ways. For example, the City of Berkeley imposes a 10-year waiting period between a no-fault eviction and when housing providers may convert that respective unit to a condominium, and it also limits condominium conversions to a citywide maximum of 100 units per year. On the other hand, the City of San Francisco allows only buildings with between two and six units to be converted to condominiums. Three cities (27%) offer evicted tenants priority on their local affordable housing waiting lists; three cities (27%) levy impact fees on or require one-for-one replacement of withdrawn rent stabilized units, or provide legal assistance or case management; only Beverly Hills requires extended noticing for Ellis Act evictions (30 additional days' notice to tenants is required); and Berkeley limits the ability for buildings to be demolished following the withdrawal of units pursuant to the Ellis Act.

In addition to these various policies that cities have adopted to address the Ellis Act, San Francisco has taken extensive steps to curb real estate speculation associated with the Ellis Act. For example, San Francisco has actively advocated for State legislation to impose minimum ownership periods on property owners before Ellis Act withdrawal applications may be filed, and has also created partnerships with local housing non-profits to acquire small rent-regulated buildings that are at risk of Ellis Act withdrawal.[16] Additionally, while not enacted by any city to date, other potential Ellis Act measures mentioned in city-specific studies include allowing home-sharing technology companies to list a percentage of units as short-term rentals in return for the company's assistance in developing technology to track available affordable housing within the City to assist low-income renters find permanent housing; and permitting short-term rental of units in rent-regulated properties in return for requiring a percentage of the respective property's other dwellings to be reserved as affordable to lower-income household.[17]

Policy Options

Based on the foregoing information, HR&A suggests that there are at least three plausible policy options the City Council, City staff, and the public could consider when determining how to address Ellis Act evictions:

1) **No Policy Changes:** In this case, the City would continue to require relocation fees for evictions of Chapter 5 Tenants pursuant to the Ellis Act, and the Ellis Act would not apply to Chapter 6 Tenants.
    - **Advantages to housing providers:** Required relocation fees would not be any higher than those for other no-fault evictions and housing providers would still maintain the ability to evict tenants through other types of no-fault evictions.
    - **Disadvantages to housing providers:** Chapter 5 housing providers would continue to be required to provide one-year's notice to certain types of Chapter 5 Tenants that they may seek to evict using the Ellis Act.
    - **Advantages to tenants:** Tenants would continue to be eligible for payment of relocation fees in the case of Ellis Act evictions, and Chapter 5 Tenants would continue to receive a 120-day notice or one-year notice, as applicable.
    - **Disadvantages to tenants:** Housing providers may pursue other types of no-fault evictions for Chapter 5 Tenants that are more permissive than Ellis Act evictions, and Chapter 6

[16] Keyser Marston Associates, *The Ellis Act and Its Effects on Rent-Stabilized Housing in Santa Monica,* 2017; https://www.smgov.net/uploadedFiles/Departments/Rent_Control/About_the_Rent_Control_Board/Staff_Reports/2017/Item%2012A%20Ellis%20Act%20Report.pdf

[17] Ibid.

Tenants would continue to be exposed to evictions without Ellis Act protections, other than payment of relocation fees.

Administrative Considerations: City costs associated with the Ellis Act would remain very low, as they are today, because the Ellis Act only applies to a small share of tenants protected by the RSO and there have been only three Ellis Act cases in the City to date.

2) **Expand Ellis Act Protections for Chapter 5 Tenants:** In this case, the City would adopt an ordinance with new regulations to discourage evictions of Chapter 5 Tenants pursuant to the Ellis Act. The ordinance could include measures that other cities have enacted, such as limiting certain uses following evictions, requiring impact fees or one-for-one replacement of units, and/or providing legal assistance to tenants. However, when weighing this policy option, it is important to consider that Chapter 5 Tenants make up a small share of tenants protected by the RSO, and the Ellis Act has been infrequently used in the City.
    - **Advantages to housing providers:** Chapter 6 housing providers would maintain the ability to evict tenants for any or no cause at all. Little to no advantage to Chapter 5 housing providers, other than clear specification of any new procedures.
    - **Disadvantages to housing providers:** New constraints on Chapter 5 housing providers' ability to convert their properties to other uses and/or go out of the rental housing business.
    - **Advantages to tenants:** City-specific regulations would provide further protection from Ellis Act evictions for Chapter 5 Tenants, as well as a potentially broader safety net when Ellis Act evictions occur.
    - **Disadvantages to tenants:** Housing providers may pursue other types of no-fault evictions for Chapter 5 Tenants that are more permissive than Ellis Act evictions.

    Administrative Considerations: New Ellis Act provisions would likely discourage evictions pursuant to the Ellis Act, making these types of evictions even less frequent. As such, there would not be significant additional costs for staff time or other resources resulting from this policy option.

3) **If a Just-Cause Evictions Ordinance is Adopted for Chapter 6, Expand Ellis Act Provisions to Apply to Chapter 6 Tenants:** In this case, if the City were to adopt a just-cause evictions ordinance for Chapter 6, which would prohibit no-cause evictions and therefore create the possibility for Chapter 6 Tenants to be evicted pursuant to the Ellis Act, the City must create Ellis Act provisions for Chapter 6 that includes requiring relocation fees, limiting certain uses following Ellis Act removal, requiring impact fees or one-for-one replacement of units, and/or providing legal assistance to tenants.
    - **Advantages to housing providers:** Little to no advantage to housing providers.
    - **Disadvantages to housing providers:** In addition to losing the ability to evict tenants for no stated reason with the adoption of a just-cause ordinance for Chapter 6 Tenants, housing providers might be further limited in their application of the Ellis Act to remove rental units from the housing market.
    - **Advantages to tenants:** Chapter 6 Tenants could no longer be evicted without a stated cause, and they would potentially be protected by new Ellis Act requirements.
    - **Disadvantages to tenants:** The degree to which Chapter 6 Tenants are protected from eviction would depend on the type and number of Ellis Act provisions adopted by the City,

and housing providers may pursue other types of no-fault evictions that are more permissive than Ellis Act evictions.

Administrative Considerations: Expanding the potential application of the Ellis Act to Chapter 6, by adopting a just-cause evictions ordinance for Chapter 6, would expose the majority of units subject to the RSO to potential removal pursuant to the Ellis Act. While it is not possible to anticipate how many Chapter 6 housing providers might utilize the Ellis Act, an increase in Ellis Act removals would necessitate additional staff resources to process these evictions and enforce compliance. There could be potentially significant staff costs required to draft and administer the related Just-Cause Eviction Ordinance.

Attachment A
Ellis Act

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GOVERNMENT CODE - GOV

TITLE 1. GENERAL [100 - 7914] *(Title 1 enacted by Stats. 1943, Ch. 134.)*

DIVISION 7. MISCELLANEOUS [6000 - 7599.2] *(Division 7 enacted by Stats. 1943, Ch. 134.)*

CHAPTER 12.75. Residential Real Property [7060 - 7060.7] *(Chapter 12.75 added by Stats. 1985, Ch. 1509, Sec. 1.)*

7060. (a) No public entity, as defined in Section 811.2, shall, by statute, ordinance, or regulation, or by administrative action implementing any statute, ordinance or regulation, compel the owner of any residential real property to offer, or to continue to offer, accommodations in the property for rent or lease, except for guestrooms or efficiency units within a residential hotel, as defined in Section 50519 of the Health and Safety Code, if the residential hotel meets all of the following conditions:

(1) The residential hotel is located in a city and county, or in a city with a population of over 1,000,000.

(2) The residential hotel has a permit of occupancy issued prior to January 1, 1990.

(3) The residential hotel did not send a notice of intent to withdraw the accommodations from rent or lease pursuant to subdivision (a) of Section 7060.4 that was delivered to the public entity prior to January 1, 2004.

(b) For the purposes of this chapter, the following definitions apply:

(1) "Accommodations" means either of the following:

(A) The residential rental units in any detached physical structure containing four or more residential rental units.

(B) With respect to a detached physical structure containing three or fewer residential rental units, the residential rental units in that structure and in any other structure located on the same parcel of land, including any detached physical structure specified in subparagraph (A).

(2) "Disabled" means a person with a disability, as defined in Section 12955.3 of the Government Code.

(Amended by Stats. 2003, Ch. 766, Sec. 1. Effective January 1, 2004.)

7060.1. Notwithstanding Section 7060, nothing in this chapter does any of the following:

(a) Prevents a public entity from enforcing any contract or agreement by which an owner of residential real property has agreed to offer the accommodations for rent or lease in consideration for a direct financial contribution or, with respect to written contracts or agreements entered into prior to July 1, 1986, for any consideration. Any contract or agreement specified in this subdivision is not enforceable against a person who acquires title to the accommodations as a bona fide purchaser for value (or successors in interest thereof), unless (1) the purchaser at the time of acquiring title to the accommodations has actual knowledge of the contract or agreement, or (2) a written memorandum of the contract or agreement which specifically describes the terms thereof and the affected real property, and which identifies the owner of the property, has been recorded with the county recorder prior to July 1, 1986, or not less than 30 days prior to transfer of title to the property to the purchaser. The county recorder shall index such a written memorandum in the grantor-grantee index.

As used in this subdivision, "direct financial contribution" includes contributions specified in Section 65916 and any form of interest rate subsidy or tax abatement provided to facilitate the acquisition or development of real property.

(b) Diminishes or enhances, except as specifically provided in Section 7060.2, any power which currently exists or which may hereafter exist in any public entity to grant or deny any entitlement to the use of real property, including, but not limited to, planning, zoning, and subdivision map approvals.

(c) Diminishes or enhances any power in any public entity to mitigate any adverse impact on persons displaced by reason of the withdrawal from rent or lease of any accommodations.

(d) Supersedes any provision of Chapter 16 (commencing with Section 7260) of this division, Part 2.8 (commencing with Section 12900) of Division 3 of Title 2 of this code, Chapter 5 (commencing with Section 17200) of Part 2 of Division 7 of the Business and Professions Code, Part 2 (commencing with Section 43) of Division 1 of the Civil Code, Title 5 (commencing with Section 1925) of Part 4 of Division 3 of the Civil Code, Chapter 4 (commencing with Section 1159) of Title 3 of Part 3 of the Code of Civil Procedure, or Division 24 (commencing with Section 33000) of the Health and Safety Code.

(e) Relieves any party to a lease or rental agreement of the duty to perform any obligation under that lease or rental agreement.

(Amended by Stats. 2003, Ch. 766, Sec. 2. Effective January 1, 2004.)

7060.2. If a public entity, by valid exercise of its police power, has in effect any control or system of control on the price at which accommodations may be offered for rent or lease, that entity may, notwithstanding any provision of this chapter, provide by statute or ordinance, or by regulation as specified in Section 7060.5, that any accommodations which have been offered for rent or lease and which were subject to that control or system of control at the time the accommodations were withdrawn from rent or lease, shall be subject to the following:

(a) (1) For all tenancies commenced during the time periods described in paragraph (2), the accommodations shall be offered and rented or leased at the lawful rent in effect at the time any notice of intent to withdraw the accommodations is filed with the public entity, plus annual adjustments available under the system of control.

(2) The provisions of paragraph (1) shall apply to all tenancies commenced during either of the following time periods:

(A) The five-year period after any notice of intent to withdraw the accommodations is filed with the public entity, whether or not the notice of intent is rescinded or the withdrawal of the accommodations is completed pursuant to the notice of intent.

(B) The five-year period after the accommodations are withdrawn.

(3) This subdivision shall prevail over any conflicting provision of law authorizing the landlord to establish the rental rate upon the initial hiring of the accommodations.

(b) If the accommodations are offered again for rent or lease for residential purposes within two years of the date the accommodations were withdrawn from rent or lease, the following provisions shall govern:

(1) The owner of the accommodations shall be liable to any tenant or lessee who was displaced from the property by that action for actual and exemplary damages. Any action by a tenant or lessee pursuant to this paragraph shall be brought within three years of the withdrawal of the accommodations from rent or lease. However, nothing in this paragraph precludes a tenant from pursuing any alternative remedy available under the law.

(2) A public entity which has acted pursuant to this section may institute a civil proceeding against any owner who has again offered accommodations for rent or lease subject to this subdivision, for exemplary damages for displacement of tenants or lessees. Any action by a public entity pursuant to this paragraph shall be brought within three years of the withdrawal of the accommodations from rent or lease.

(3) Any owner who offers accommodations again for rent or lease shall first offer the unit for rent or lease to the tenant or lessee displaced from that unit by the withdrawal pursuant to this chapter, if the tenant has advised the owner in writing within 30 days of the displacement of his or her desire to consider an offer to renew the tenancy and has furnished the owner with an address to which that offer is to be directed. That tenant, lessee, or former tenant or lessee may advise the owner at any time during the eligibility of a change of address to which an offer is to be directed.

If the owner again offers the accommodations for rent or lease pursuant to this subdivision, and the tenant or lessee has advised the owner pursuant to this subdivision of a desire to consider an offer to renew the tenancy, then the owner shall offer to reinstitute a rental agreement or lease on terms permitted by law to that displaced tenant or lessee.

This offer shall be deposited in the United States mail, by registered or certified mail with postage prepaid, addressed to the displaced tenant or lessee at the address furnished to the owner as provided in this subdivision, and shall describe the terms of the offer. The displaced tenant or lessee shall have 30 days from the deposit of the offer in the mail to accept the offer by personal delivery of that acceptance or by deposit of the acceptance in the United States mail by registered or certified mail with postage prepaid.

(c) A public entity which has acted pursuant to this section, may require by statute or ordinance, or by regulation as specified in Section 7060.5, that an owner who offers accommodations again for rent or lease within a period not exceeding 10 years from the date on which they are withdrawn, and which are subject to this subdivision, shall first offer the unit to the tenant or lessee displaced from that unit by the withdrawal, if that tenant or lessee requests

the offer in writing within 30 days after the owner has notified the public entity of an intention to offer the accommodations again for residential rent or lease pursuant to a requirement adopted by the public entity under subdivision (c) of Section 7060.4. The owner of the accommodations shall be liable to any tenant or lessee who was displaced by that action for failure to comply with this paragraph, for punitive damages in an amount which does not exceed the contract rent for six months.

(d) If the accommodations are demolished, and new accommodations are constructed on the same property, and offered for rent or lease within five years of the date the accommodations were withdrawn from rent or lease, the newly constructed accommodations shall be subject to any system of controls on the price at which they would be offered on the basis of a fair and reasonable return on the newly constructed accommodations, notwithstanding any exemption from the system of controls for newly constructed accommodations.

(e) The amendments to this section enacted by the act adding this subdivision shall apply to all new tenancies created after December 31, 2002. If a new tenancy was lawfully created prior to January 1, 2003, after a lawful withdrawal of the unit under this chapter, the amendments to this section enacted by the act adding this subdivision may not apply to new tenancies created after that date.

(Amended by Stats. 2002, Ch. 301, Sec. 5. Effective January 1, 2003.)

7060.3. If a public entity determines to apply constraints pursuant to Section 7060.2 to a successor in interest of an owner who has withdrawn accommodations from rent or lease, the public entity shall record a notice with the county recorder which shall specifically describe the real property where the accommodations are located, the dates applicable to the constraints and the name of the owner of record of the real property. The notice shall be indexed in the grantor-grantee index.

A person who acquires title to the real property subsequent to the date upon which the accommodations thereon have been withdrawn from rent or lease, as a bona fide purchaser for value, shall not be a successor in interest for the purposes of this chapter if the notice prescribed by this section has not been recorded with the county recorder at least one day before the transfer of title.

(Amended by Stats. 1986, Ch. 509, Sec. 1.)

7060.4. (a) Any public entity which, by a valid exercise of its police power, has in effect any control or system of control on the price at which accommodations are offered for rent or lease, may require by statute or ordinance, or by regulation as specified in Section 7060.5, that the owner notify the entity of an intention to withdraw those accommodations from rent or lease and may require that the notice contain statements, under penalty of perjury, providing information on the number of accommodations, the address or location of those accommodations, the name or names of the tenants or lessees of the accommodations, and the rent applicable to each residential rental unit.

Information respecting the name or names of the tenants, the rent applicable to any residential rental unit, or the total number of accommodations, is confidential information and for purposes of this chapter shall be treated as confidential information by any public entity for purposes of the Information Practices Act of 1977 (Chapter 1 (commencing with Section 1798) of Title 1.8 of Part 4 of Division 3 of the Civil Code). A public entity shall, to the extent required by the preceding sentence, be considered an "agency," as defined by subdivision (d) of Section 1798.3 of the Civil Code.

(b) The statute, ordinance, or regulation of the public entity may require that the owner record with the county recorder a memorandum summarizing the provisions, other than the confidential provisions, of the notice in a form which shall be prescribed by the statute, ordinance, or regulation, and require a certification with that notice that actions have been initiated as required by law to terminate any existing tenancies. In that situation, the date on which the accommodations are withdrawn from rent or lease for purposes of this chapter is 120 days from the delivery in person or by first-class mail of that notice to the public entity. However, if the tenant or lessee is at least 62 years of age or disabled, and has lived in his or her accommodations for at least one year prior to the date of delivery to the public entity of the notice of intent to withdraw pursuant to subdivision (a), then the date of withdrawal of the accommodations of that tenant or lessee shall be extended to one year after the date of delivery of that notice to the public entity, provided that the tenant or lessee gives written notice of his or her entitlement to an extension to the owner within 60 days of the date of delivery to the public entity of the notice of intent to withdraw. In that situation, the following provisions shall apply:

(1) The tenancy shall be continued on the same terms and conditions as existed on the date of delivery to the public entity of the notice of intent to withdraw, subject to any adjustments otherwise available under the system of control.

(2) No party shall be relieved of the duty to perform any obligation under the lease or rental agreement.

(3) The owner may elect to extend the date of withdrawal on any other accommodations up to one year after date of delivery to the public entity of the notice of intent to withdraw, subject to paragraphs (1) and (2).

(4) Within 30 days of the notification by the tenant or lessee to the owner of his or her entitlement to an extension, the owner shall give written notice to the public entity of the claim that the tenant or lessee is entitled to stay in their accommodations for one year after date of delivery to the public entity of the notice of intent to withdraw.

(5) Within 90 days of date of delivery to the public entity of the notice of intent to withdraw, the owner shall give written notice to the public entity and the affected tenant or lessee of the owner's election to extend the date of withdrawal and the new date of withdrawal under paragraph (3).

(c) The statute, ordinance, or regulation of the public entity adopted pursuant to subdivision (a) may also require the owner to notify any tenant or lessee displaced pursuant to this chapter of the following:

(1) That the public entity has been notified pursuant to subdivision (a).

(2) That the notice to the public entity specified the name and the amount of rent paid by the tenant or lessee as an occupant of the accommodations.

(3) The amount of rent the owner specified in the notice to the public entity.

(4) Notice to the tenant or lessee of his or her rights under paragraph (3) of subdivision (b) of Section 7060.2.

(5) Notice to the tenant or lessee of the following:

(A) If the tenant or lessee is at least 62 years of age or disabled, and has lived in his or her accommodations for at least one year prior to the date of delivery to the public entity of the notice of intent to withdraw, then tenancy shall be extended to one year after date of delivery to the public entity of the notice of intent to withdraw, provided that the tenant or lessee gives written notice of his or her entitlement to the owner within 60 days of date of delivery to the public entity of the notice of intent to withdraw.

(B) The extended tenancy shall be continued on the same terms and conditions as existed on date of delivery to the public entity of the notice of intent to withdraw, subject to any adjustments otherwise available under the system of control.

(C) No party shall be relieved of the duty to perform any obligation under the lease or rental agreement during the extended tenancy.

(d) The statute, ordinance, or regulation of the public entity adopted pursuant to subdivision (a) may also require the owner to notify the public entity in writing of an intention to again offer the accommodations for rent or lease.

(Amended by Stats. 2004, Ch. 568, Sec. 7. Effective January 1, 2005.)

7060.5. The actions authorized by Sections 7060.2 and 7060.4 may be taken by regulation adopted after public notice and hearing by a public body of a public entity, if the members of the body have been elected by the voters of the public entity. The regulation shall be subject to referendum in the manner prescribed by law for the ordinances of the legislative body of the public entity except that:

(a) The decision to repeal the regulation or to submit it to the voters shall be made by the public body which adopted the regulation.

(b) The regulation shall become effective upon adoption by the public body of the public entity and shall remain in effect until a majority of the voters voting on the issue vote against the regulation, notwithstanding Section 9235, 9237, or 9241 of the Elections Code or any other law.

(Amended by Stats. 1994, Ch. 923, Sec. 36. Effective January 1, 1995.)

7060.6. If an owner seeks to displace a tenant or lessee from accommodations withdrawn from rent or lease pursuant to this chapter by an unlawful detainer proceeding, the tenant or lessee may appear and answer or demur pursuant to Section 1170 of the Code of Civil Procedure and may assert by way of defense that the owner has not complied with the applicable provisions of this chapter, or statutes, ordinances, or regulations of public entities adopted to implement this chapter, as authorized by this chapter.

(Added by Stats. 1985, Ch. 1509, Sec. 1. Operative July 1, 1986, by Sec. 2 of Ch. 1509.)

7060.7. It is the intent of the Legislature in enacting this chapter to supersede any holding or portion of any holding in Nash v. City of Santa Monica, 37 Cal.3d 97 to the extent that the holding, or portion of the holding, conflicts with this chapter, so as to permit landlords to go out of business. However, this act is not otherwise intended to do any of the following:

(a) Interfere with local governmental authority over land use, including regulation of the conversion of existing housing to condominiums or other subdivided interests or to other nonresidential use following its withdrawal from rent or lease under this chapter.

(b) Preempt local or municipal environmental or land use regulations, procedures, or controls that govern the demolition and redevelopment of residential property.

(c) Override procedural protections designed to prevent abuse of the right to evict tenants.

(d) Permit an owner to withdraw from rent or lease less than all of the accommodations, as defined by paragraph (1) or (2) of subdivision (b) of Section 7060.

(e) Grant to any public entity any power which it does not possess independent of this chapter to control or establish a system of control on the price at which accommodations may be offered for rent or lease, or to diminish any such power which that public entity may possess, except as specifically provided in this chapter.

(f) Alter in any way either Section 65863.7 relating to the withdrawal of accommodations which comprise a mobilehome park from rent or lease or subdivision (f) of Section 798.56 of the Civil Code relating to a change of use of a mobilehome park.

(Amended by Stats. 1999, Ch. 968, Sec. 4. Effective January 1, 2000.)