

AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: March 21, 2018

Final Decision Date Deadline: March 21, 2018

STATEMENT OF THE ISSUE: Section 11.100.070 of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance ("Rent Ordinance") provides that "landlords have a right to a reasonable return on their investment" or right to a reasonable or fair return. The primary vehicle for achieving a "fair return" is the Annual General Adjustment, which, when applied to the Base Rent creates the Maximum Allow Rent level. When a landlord is not achieving a fair return by way of the Annual General Adjustment, the Ordinance allows landlords to petition the Board to increase the rent above the Maximum Allowable Rent. Staff members have incorporated comments from members of the Board and community and are recommending adoption of the proposed regulation.

INDICATE APPROPRIATE BODY

- | | | | | |
|---|---|--|--|---|
| <input type="checkbox"/> City Council | <input type="checkbox"/> Redevelopment Agency | <input type="checkbox"/> Housing Authority | <input type="checkbox"/> Surplus Property Authority | <input type="checkbox"/> Joint Powers Financing Authority |
| <input type="checkbox"/> Finance Standing Committee | <input type="checkbox"/> Public Safety Public Services Standing Committee | <input type="checkbox"/> Local Reuse Authority | <input checked="" type="checkbox"/> Other: <u>Rent Board</u> | |

ITEM

- Presentation/Proclamation/Commendation (3-Minute Time Limit)
- Public Hearing Regulation Other:
- Contract/Agreement Rent Board As Whole
- Grant Application/Acceptance Claims Filed Against City of Richmond
- Resolution Video/PowerPoint Presentation (contact KCRT @ 620.6759)

RECOMMENDED ACTION: ADOPT proposed Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9) – Rent Program (Nicolas Traylor/Michael Roush 620-6564).

AGENDA ITEM NO:

G-1.



AGENDA REPORT

DATE: March 21, 2018

TO: Chair Gray and Members of the Rent Board

FROM: Nicolas Traylor, Executive Director
Michael Roush, Legal Counsel
Dr. Kenneth Baar, Consultant

SUBJECT: PROPOSED MAINTENANCE OF NET OPERATING INCOME (MNOI)
FAIR RETURN REGULATION (CHAPTER 9)

STATEMENT OF THE ISSUE:

Section 11.100.070 of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance (“Rent Ordinance”) provides that “landlords have a right to a reasonable return on their investment” or right to a reasonable or fair return. The primarily vehicle for achieving a “fair return” is the Annual General Adjustment, which, when applied to the Base Rent creates the Maximum Allow Rent level. When a landlord is not achieving a fair return by way of the Annual General Adjustment, the Ordinance allows landlords to petition the Board to increase the rent above the Maximum Allowable Rent. Staff members have incorporated comments from members of the Board and community and are recommending adoption of the proposed regulation.

RECOMMENDED ACTION:

ADOPT proposed Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9) – Rent Program (Nicolas Traylor/Michael Roush 620-6564).

FISCAL IMPACT:

The cost to administer the Rent Adjustment/Fair Return Petition process is accounted for in the Fiscal Year 2017-18 Rent Program Budget. The proposed draft regulations do not provide for a filing fee at this time, but allows the Rent Board to establish such a fee in the future if deemed appropriate.

DISCUSSION:

Background

For most multi-family rental properties in the City of Richmond, rent increases are limited to the annual change in the Consumer Price Index (a measure of inflation). The Richmond Fair Rent, Just Cause for Eviction and Homeowner Protection Ordinance provides for the right to a reasonable return and tasks the Rent Board with promulgating Fair Return regulations.

The Maintenance of Net Operating Income regulation establishes standards for allowing an increase above the Maximum Allowable Rent level in cases where the landlord is not receiving a fair return. "Fair Return" is defined as the right to obtain a net operating income equal to the base year net operating income adjusted by a set percentage increase in the Consumer Price Index (CPI), since the base year. In future Board meetings, Board members will be tasked with reviewing and adopting two additional Fair Return regulations: a capital improvement regulation and historically low rent regulation.

At its January 24, 2018, Special Meeting, the Board adopted regulations to inform the *procedures* whereby Tenants and Landlords can request individual adjustments in the Maximum Allowable Rent. At its February 21, 2018, Regular Meeting, the Board adopted regulations regarding the *substantive* standards for rent adjustments due to changes in space, services, or habitability, as well as rent registration and vacancy rent increase regulations to assist in determining the Maximum Allowable Rent. The tracking of rent levels and vacancy rent increases is necessary to properly adjudicate individual rent adjustment cases. Since Landlords are constitutionally entitled to a fair return, the Board must also consider and adopt regulations determining fair return standards. At their meeting on December 20, 2017, the Board received a presentation and memo from Dr. Kenneth Baar regarding standards for determining fair return. The Board directed staff to prepare a draft regulation utilizing a Maintenance of Net Operating Income (MNOI) approach.

The Board received an initial draft of the proposed Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9) at its February 21, 2018, Regular Meeting, and continued to discuss the proposed regulation at its February 28, 2018, meeting. At its February 28, 2018, Special Meeting, the Board provided the following direction to staff:

1. Conduct a study on the impacts of partial indexing (100%, 75%, and 65%) of the Base Year Net Operating Income (NOI) and include examples and explanations (Refer to Attachment 2)
2. Define the Base Year as 2015 (incorporated in Attachments 3 & 4)
3. Resulting rent increases from the MNOI Rent Adjustment Petition process shall be capped at 15% per year (incorporated in Attachment 3 & 4)

4. Consideration of amortized capital improvements shall be a permanent (rather than temporary) concept as it relates to changes in the Net Operating Income.¹

Community Engagement

Regulations governing rent adjustment standards, vacancy rent increases and rent registration will have community-wide impact and are a critical task to further the intent and purpose of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance.

As a first step towards achieving this task, Rent Program staff members held Community Workshops on December 4, 2017, and December 9, 2017, to inform and solicit feedback from community members about possible models and standards for adjusting the Maximum Allowable Rent due to:

- Increases in Operating Expenses/Fair Return Standards
- Increases or Decreases in Space, Services, or Habitability
- Capital/Building Improvements
- Historically Low Rents

A summary of community feedback gathered for increases in operating expenses and fair return standards are contained in Attachment 5.

A copy of the draft substantive rent adjustment regulations for the Board's consideration were posted on the Rent Program website and a listserv message was sent with instructions for submitting comments prior to February 28, 2018 Board meeting.

During the months of February and March, staff members met with representatives of the Fair and Affordable Richmond coalition and Association of United Richmond Housing Providers to discuss their comments on the draft regulations.

Updates regarding the process of developing Rent Adjustment Regulations will be posted at <http://www.ci.richmond.ca.us/3521/Rent-Adjustment-Regulations> and disseminated via the Rent Program listserv.

Overview of Maintenance of Net Operating Income (MNOI) Regulation

The table on the following page contains a brief summary of the proposed MNOI regulation (Attachment 1).

¹ Staff recommends the Board consider a permanent (rather than temporary) concept as it relates to a separate capital improvement pass-through policy, which will be presented to the Board at a subsequent meeting. For the purposes of calculating net operating income, staff recommend the Board keep the temporary amortization of capital improvements as written in the original regulation. As such, this direction has NOT been incorporated into the proposed Maintenance of Net Operating Income (MNOI) regulation.

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Maintenance of Net Operating (MNOI) Fair Return Standard Regulation (Chapter 9)		
Regulation Section	Title	Purpose
905(A)(1)	Presumption of Fair Base Year	Establishes that the Net operating income received by the Landlord in the Base Year provided a Fair Return
905(A)(2)	Fair Return	Establishes that a landlord has the right to obtain a net operating income equal to the base year NOI adjusted by X% of the percentage in the CPI since the Base Year
905(A)(3) and 905 (A)(4)	Base Year and Current Year	Regulation that establishes the Base and current years for MNOI standard
905(A)(5)	Adjustment of Base Year Net Operating Income	This regulation allows Landlords to rebut the assumption that the Base Year provided a Fair Return- either due to exceptional expense circumstances in the Base Year
905(A)(6)	Calculation of Net Operating Income	This regulation provides the formula for calculating net operating income and defines Gross Rental Income and Operating Expenses (maintenance/operational costs, utility costs, real property taxes, licenses and fees, landlord-performed labor, legal expense and the amortized costs of capital improvements)
905(A)(6)(a)	Amortization of Capital Improvements	905 (A) (6) (a) viii defines how costs are amortized using an interest allowance. (A) (6) (b) (x) requires that capital improvement increases be terminated for tenancies which have had their rents reset through vacancy rent increases. 905 (A) (6) (c) describes what types of operating expenses shall not be included in the fair return calculation
905(A)(6)(b)	Impact of Vacancy Rent Increases on Capital Improvements Increases	
905(A)(6)(c)	Types of Operating Expenses Not Included in Fair Return Calculation	

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Maintenance of Net Operating (MNOI) Fair Return Standard Regulation (Chapter 9)		
Regulation Section	Title	Purpose
905(A)(6)(d)	Adjustment to Operating Expenses	Base year and/or current year operating expenses may be averaged in cases where there are exceptional costs in either the base or current year. This is done in order to establish cost for expenses that most reasonably serves the objectives of obtaining a reasonable comparison of the base year and current year, while providing a Fair Return
905(A)(6)(e)	Projections of Base Year Operating Expenses in the Absence of Actual Data	Standard that establishes how to calculate base year expense data in cases where there is an absence of actual base year expense data
905(A)(7)	Allocation of Rent Increases	Defines how authorized Fair Return rent increases would be allocated among rental units/building
905(A)(8)	Conditional Rent Adjustments for Proposed Capital Improvements	Allows a Landlord to petition for an upward rent adjustment based on anticipated future expense for capital improvements and provides for conditions for authorization and implementation of those rent increases
905(A)(9)	Impact of Recent Vacancy Rent Increases Eligibility for Capital Improvement Increase	Establishes that any unit that has received a vacancy rent increase within two years prior to the fair return application shall be ineligible for any rent increase based on the cost of the proposed capital improvement
(905)(A)(10)	Limits to Annual Rent Adjustments Based on Maintenance of Net Operating Income Standard	The purpose of this regulation is to protect tenants from substantial rent increases, by placing a limit on the amount that can be charged for a Fair Return/MNOI rent increase
905(A)(11)	Constitutional Right to a Fair Return	Provides that no section of the (proposed) Fair Return regulations shall be applied to prohibit the Board from granting a Fair Return increase

Proposed Revisions

The table on the following page describes the revisions incorporated in the proposed Maintenance of Net Operating (MNOI) Fair Return Regulation (Chapter 9) as discussed in Attachment 1 and identified in Attachment 3.

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Regulation Section	Incorporated Revision
905(A)(2) Fair Return	<p>Specifies a Landlord has the right to obtain a net operating income equal to the Base Year net operating income adjusted by 100% of the percentage increase in the Consumer Price Index (CPI), since the Base Year. It shall be presumed this standard provides a Fair Return.</p> <p><u>Rationale:</u> The Annual General Adjustment is based upon 100% of the CPI.</p>
905(A)(3) Base Year	<p>Define 2015 as the Base Year.</p> <p><u>Rationale:</u> Consistent with Board direction.</p>
905(A)(6)(a) Calculation of Net Operating Income and Gross Rental Income	<p><u>Original provision:</u> “If there are vacant units at the time a petition is filed the rent shall be calculated on the basis of average rents for comparable units in the property which have had vacancy increases within the past two years. If there are no comparable units in the property, rental income for the vacant unit shall be calculated on the basis of rents for recently established initial rents for comparable units in the City.</p> <p><u>Revised provision:</u> “If there is a difference in the number of Rental Units between the Base Year and the current year, in making calculations of net operating income in the Base Year and current year, the rental income and expenses for the same number of units shall be used in calculating the net operating income for both periods. The purpose of this provision is to ensure that a petitioner is not requesting that the current fair net operating income reach a level which was provided in the Base Year by a larger number of units or is limited to a net operating income which was formerly provided by a smaller number of units. If there are units that are vacant or owner-occupied at the time a petition is filed which were rented in the Base Year, for the purposes of the MNOI analysis a rental income for the unit shall be calculated on the basis of average rents for comparable units in the building which have been permitted vacancy decontrol increases within the past two years. If there are no comparable units in the property, rental income for the vacant or owner occupied units, the rent shall be calculated on the basis of recently established initial rents for comparable units in the City. If there are units that were rented in the current year, which were vacant or owner occupied in the Base Year, for the purposes of the MNOI analysis, a rental income for the unit for the Base Year shall be calculated on the basis of average rents for comparable units in the building in the Base Year. If there are no comparable units in the property, rental income for the vacant or owner occupied units in the Base Year shall be calculated on the basis of base year rents for comparable units in the City. In the alternative, the Hearing Examiner may use another reasonable methodology to ensure compliance with the purposes of this subsection.</p> <p><u>Rationale:</u> To ensure that a petitioner is not requesting that the current fair net operating income reach a level which was provided in the Base Year by a larger number of units or is limited to a net operating income which was formerly provided by a smaller number of units.</p>

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Regulation Section	Incorporated Revision
905(A)(6)(b) Calculation of Net Operating Income and Operating Expenses	<p>Remove the reference to property insurance in subsection (i).</p> <p>Add “and insurance” to subsection (iv) such that the subsection is titled, “Real property taxes and insurance.”</p> <p><u>Rationale:</u> It makes more sense to group “insurance” in the category of “real property taxes.”</p>
905(A)(6)(b) Calculation of Net Operating Income and Operating Expenses	<p>Replace the term “replacements” with “improvements” in subsection viii, so the term is “Capital Improvements,” not “Capital Replacements.”</p> <p>Insert amortization schedule for Capital Improvements</p> <p>Delete the amortized cost table (for illustrative purposes only)</p> <p><u>Rationale:</u> To maintain consistency of terminology. “Capital improvements” is the term used in the Regulation.</p>
905(A)(8)(c) Conditional Rent Adjustments for Proposed Capital Improvements	<p><u>Original provision:</u> No addendum shall be issued for such proposed capital improvements unless they are completed within twelve months from the date of final decision granting the conditional rent adjustment, unless the Landlord obtains an additional addenda authorization an extension of the time period to complete the capital improvement. If supported by just cause such extensions shall be granted.</p> <p><u>Revised provision:</u> No addendum shall be issued for such proposed capital improvements unless they are completed within twenty-four (24) months from the date of final decision granting the conditional rent adjustment, unless the Landlord obtains an additional addenda authorization an extension of the time period to complete the capital improvement.</p> <p>Extensions may be granted due to reasonable delays in the completion of capital improvements as determined by the Hearing Examiner.</p> <p><u>Rationale:</u> Staff recommends that the time period for conditional approval be 24 months instead of 12 month, considering the reasonable possibility that it can take many months to secure permits, plans and due to reasonable delays due to weather and other uncontrollable events. While the current regulation allows a landlord to request an extension of more than 12 months, allowing for 24 months will help reduce administrative burden and avoid unnecessary debate regarding the reasonableness of an extension request and subsequent possible denial of that request.</p>

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Regulation Section	Incorporated Revision
905(A)(9) Conditional Rent Adjustments for Proposed Capital Improvements	<p><u>Existing Provision:</u> Any unit which received a vacancy rent increase pursuant to Civil Code Section 1954.53 within the two years prior to the Fair Return application shall be ineligible for a rent increase for the portion of any rent increased based on the cost of proposed capital improvements.</p> <p><u>Revised Provision:</u> Any unit which received a vacancy rent increase pursuant to Civil Code Section 1954.53 within the one (1) year prior to the Fair Return application shall be ineligible for a rent increase for the portion of any rent increased based on the cost of proposed capital improvements.</p> <p><u>Rationale:</u> Staff recommends this time period be reduced to one year since a longer time period may discourage landlords from making necessary capital improvements. In other words, if a tenant has moved in within 24 months and the landlord will be ineligible to apply an individual rent adjustment to them, they may wait until this restriction period expires.</p>
905(B) Rent Increase Limit	<p>Specify that the implementation of a Maximum Allowable Rent increase shall be limited each year to 15% of the Maximum Allowable Rent on the date the petition was filed.</p> <p><u>Rationale:</u> Consistent with Board direction.</p>

DOCUMENTS ATTACHED:

Attachment 1 – Memo describing community feedback and staff recommendations

Attachment 2 – Partial Indexing Examples

Attachment 3 – Revised Maintenance of Net Operating Income (MNOI) Fair Return Regulation (Chapter 9)

Attachment 4 - “Clean” Maintenance of Net Operating Income (MNOI) Fair Return Regulation (MNOI) (Chapter 9)

Attachment 5 – Summary of Community Feedback regarding Increases in Operating Expenses/Fair Return Standards



**Attachment 1: Responding to Feedback from the
Association of United Richmond Housing Providers (AURHP)**

Feedback #1 Regarding Maintenance of Net Operating Income (MNOI) Fair Return Standard From AURHP:

“The presumption that any given year all or most properties were making a fair return is invalid. Sometimes properties lose money when they are first purchased. Does this mean a negative return is a fair return because it didn't make money when purchased? Often there are problems with a building's condition or management that the owner can correct and generate a much higher return over time. An item purchased for \$100 in 2000 now costs \$500 in 2018. (<http://www.usinflationcalculator.com/>) So even if the rent went up by \$400 over this time, there is NO increase in return to the owner. The owner is getting nothing on her investment.”

*“Using the section 8 standard listed for the base year provides a clear, universally applicable way to ensure housing providers no be prevented from fair return by having in place unusually low rents from achieving a fair return
Would this obviate the need for separate HLA?”*

“Reasons for using an objective universal metric rather than individual cash flow for a given year: What if the base year NOI is negative? This adjustment percentage also needs to be bigger than 100%. At 100% of CPI, there is never an increase in return for the owner. As time goes on and the value of the dollar decreases, the owner needs more money from tenants just to keep up with the increases in expenses. There is no increase of income for the owner. AGA is already defined in original ordinance as 100% of CPI”

Staff Response and Recommendation #1:

AURHP has proposed that the HUD FMR (fair market rent) standard should be used to set allowable rent levels in individual rent adjustment cases. The FMR standard is used to set a ceiling on what rents will be covered by HUD Section 8 rent allowances. The FMR is set at the 40% level among market rents. (In other words, at that level 60% of all units within a category have higher rents and 40% have lower rents.)

The ordinance limits annual rent increases to the percentage increase in the Consumer Price Index. In order to meet constitutional fair return requirements the ordinance also authorizes individual rent adjustment petitions in order to enable apartment owners to obtain a fair return.

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The section on fair return lists criteria to be considered in making fair return rent adjustments. The scope of the adjustments is subject to a limitation on increases to the amounts necessary to provide a fair return.

It is the intent of this chapter that individual upward adjustments in the rent ceilings on units be made only when the landlord demonstrates that such adjustments are necessary to provide the landlord with a fair return on investment. (Section 11.100.070 (g) (8))

Assuming that the average rent levels in Richmond were the same as the average in the FMR survey area, if the FMR standard were adopted, apartment owners would be entitled to a rent adjustment for 40% of the rental units in the City.

The use of the FMR in order to set allowable rents approach would constitute a general “resetting” of rents rather than “stabilization” of rents.

Such a resetting of rents is not required to meet constitutional fair return standards. Instead, the courts have held that an owner entitled to a readjustment of base rents and net operating income in cases where the base year level does not reflect market conditions. Such cases occur when base rents are exceptionally low or other circumstances that depressed base period income (such as an exceptional operating expense, due to flooding or a fire).

Furthermore, in viewing FMR rents as a standard it may be noted that:

- 1) Assuming that apartment owners set rents based on market conditions, the lower rent units within a category (e.g. two bedroom units) typically would have a lower market rental value due to factors such as size, condition, amenities, and location, as opposed to charging rents which do not reflect market conditions.
- 2) The data base for setting FMR’s includes markets with substantially higher rents than Richmond area rents. For example, a HUD Housing Market Analysis in January 2017 reported that average rents were \$2,550 in the Oakland/Berkeley market and approximately \$2,188 in the Fremont area, compared to \$1,707 in Northwest Contra Costa market areas.¹ As a result, the use of an FMR standard to set allowable rents in Richmond would authorize rent adjustments for more than 40% of all units.

If the primary purpose of the Richmond Fair Rent, Just Cause for Eviction and Homeowner Protection Ordinance is to stabilize rent levels in Richmond, the proposal to

¹ U.S. Dept. of HUD, Office of Policy Development and Research, [Comprehensive Housing Market Analysis](#), As of Jan. 1, 2017, Oakland-Hayward-Berkeley, p. 11.

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set the base rent on Fair Market Rent levels amounts to a resetting of rents and not a stabilization of rents in effect in 2015 (when rent regulation through the rent rollback went into effect.)

It is contrary to the intention of the Ordinance to allow the base rent to be RESET to “Fair Market Rents” as defined by the Housing Authority or HUD. The purpose of the law is to tie allowable rent increases to the percentage increase in the CPI, except when greater increases are necessary to provide a fair return. The MNOI standard includes a Vega adjust in cases where the rent was exceptionally low. The Board is going to consider a historically low adjustment rent regulation.

Feedback from AURHP #2 Regarding the Definition of the Base Year:

“The presumption that any given year all or most properties were making a fair return is invalid. In other words, sometimes properties lose money when they are first purchased. Does this mean a negative return is a fair return because it didn’t make money when purchased?”

Apartment owners have raised questions about the possibility that an owner may have a negative return in the base year and therefore, could not benefit from a percentage adjustment of the base year net operating income based on the MNOI standard.

Cash flow, which is income net of both operating expenses and debt service, is commonly negative or very low in the early years of a new ownership. This phenomena occurs because market purchase prices reflect expectations about appreciation, as well as current income levels.

The MNOI standard considers net operating income, rather than cash flow. It excludes consideration of mortgage debt service. Typically net operating income is equal to more than half of rental income.²

Staff Response and Recommendation #2:

No changes are recommended to this section of the Regulation. Cash flow and net operating income are two different measures of return. Cash flow accounts for debt service, including a purchase price which reflects expectations about appreciation, as well as current income levels.

² However, a negative net operating income would not occur unless there were unusual operating expenses or other unusual non-recurring circumstances. If a property had a recurring negative net operating income it would indicate that the structure on the property had no value. This is not normal in a tight rental market. Rather negative net operating incomes have occurred in deteriorating urban slum areas where market rents are so low that they cannot even cover property taxes, insurance, utility, and maintenance costs and properties were abandoned by landlords because they were worthless.

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The MNOI standard preserves a building's net operating income. Absent extraordinary circumstances, a building will maintain a positive net operating income.

A negative income (cash flow) after debt service is not the same as having a negative net operating income. A negative income (cash flow) is a function of the financing terms agreed to by the purchaser.

Feedback from AURHP #3 Regarding Definition of “Gross Income” When Units Change to or from Vacant or Owner Occupied Between the Base Year and Current Year: *“If units are withdrawn from the market, does this still count against HP (Housing Providers)? [Is this a] trap (for Housing Providers)?”*

A revised proposed regulation provides that current rental income for vacant units shall be imputed for the purposes of calculating overall net operating income for a property. An apartment representative has stated that this regulation is a “trap.”

The purpose of this provision is to ensure that a petitioner is not requesting that the current fair net operating income reach a level which was formerly provided by a larger number of units and that a petitioner is not prejudiced by the fact that more units are rented in the current year than in the base year. (For example, it would not be reasonable to request that the rental income from five units provide the net operating income that was formerly provided by seven units.) *Instead, comparisons between base year and current year net operating income levels should be based on consideration of income and expenses from the same number of rental units in both periods.*

Staff Response and Recommendation #3:

A revised proposed regulation has been written that provides that current rental income for vacant units shall be imputed for the purposes of calculating overall net operating income for a property. Staff recommends adopting this revision.

Feedback from AURHP #4 Regarding Restriction on the Portion of Capital Improvement Adjustments which are Allocated to Units Receiving a Vacancy Rent Increase within the Past Two Years:

Should landlords be able to apply MNOI increases (due to increased Capital Improvement costs) on new tenancies that have commenced within the last 12 months instead of 24 months? **Quote from AURHP:** *“This makes no sense. Just because the tenant is paying the market rent of two years ago doesn't mean they shouldn't help to pay for a capital improvement that needs to be done now? If the proposed increase would push the rent above the market, the landlord can't give that increase anyway or the tenant will move. This discourages landlord from doing capital improvements that benefit the tenant such as new double paned windows or a new paint job.”*

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The concept behind this provision is that when rents are reset at market levels the owner has had an opportunity to take into account costs that are anticipated or should have been anticipated and that a new tenant would not ordinarily anticipate such a possibility within the context of rent stabilization.

Staff Response and Recommendation #4: As written, the regulation establishes that any tenancy that starts within a year (24months) of the filing of a capital improvement increase petition shall be ineligible for a capital improvement increase. Staff recommends this time period be reduced to 12 months since a longer time period may discourage landlords from making necessary capital improvements. In other words, if a tenant has moved in within 24 months and the landlord will be ineligible to apply an individual rent adjustment to them, they may wait until this restriction period expires.

Feedback from AURHP #5 Regarding Offset of Allowable AGA's that Have Not Been Implemented Against Fair Return Adjustments:

Does the 15% cap include the current years AGA, forcing landlords to bank the current AGA?

It is not the purpose of this provision to take away AGA's that are allowed after a fair return adjustment. Instead, the purpose is to take into consideration AGA's which the owner has a right to at the time of a fair return adjustment, but has not yet implemented. Otherwise, the fair return adjustment would not be considering the currently allowable rent in determining what rent adjustment should be permitted.

Staff Response and Recommendation: No change necessary. Landlords will maintain the ability to take the current year AGA irrespective of an MNOI rent adjustment, however the landlord shall still be required to comply with regulation 17-09, which specifies landlords cannot apply more than 5% of banked AGAs in a 12-month period.

Maintenance of Net Operating Income (MNOI) Fair Return Analysis: Example Calculation

Maintenance of Net Operating Income (MNOI) Calculation Example

Item G-1: MNOI Example Calculation

Greetings!
I'm Maria



4 Unit Complex

Item G-1:
MNOI Example

MNOI calculations
begin by examining
the **Base Year net
operating income and
operating expenses...**

Example of Operating Expenses

Item G-1: Definition of “Operating Expenses”

Included in Operating Expenses

- Reasonable costs of operation and maintenance of the rental unit
- Real property taxes
- Insurance
- Utility costs
- Management expenses
- License, registration, and other public fees
- Landlord-performed labor
- Legal Expenses

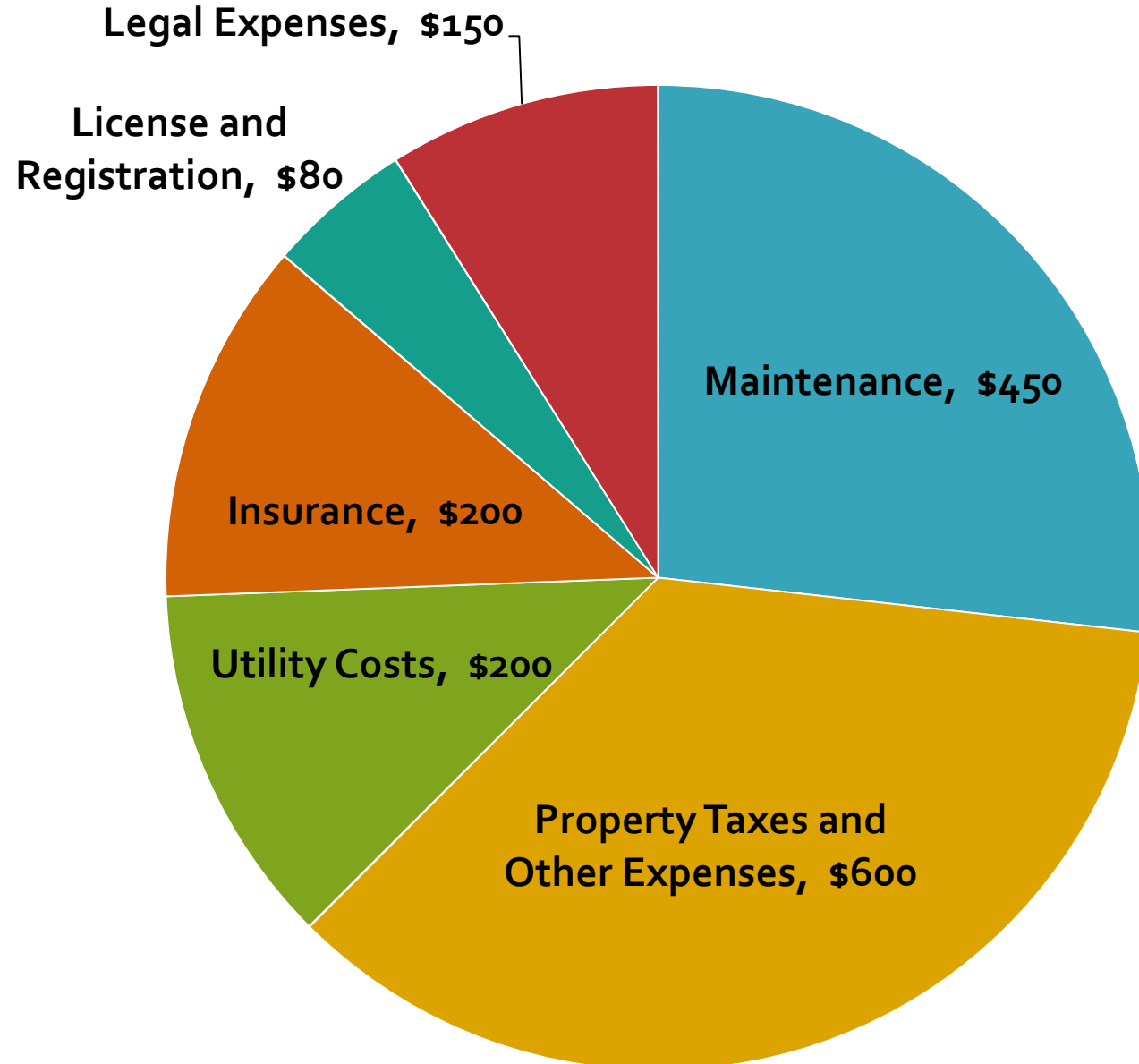
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NOT Included in Operating Expenses

- Debt service costs and costs for obtaining financing
- Mortgage payments or principal
- Any penalties, fees, or interest assessed for violation of the ordinance or law
- Land lease expenses
- Political contributions
- Depreciation
- Any expenses for which the landlord has already been reimbursed
- Unreasonable increases in expenses since the base year

Maria's Monthly Operating Expenses (Hypothetical)

Item G-1: MNOI Example Calculation



**Total Monthly
Operating
Expenses
=
\$1,680**

What is included in operating income?

Item G-1: MNOI Example Calculation



Monthly Net Operating
Income

=

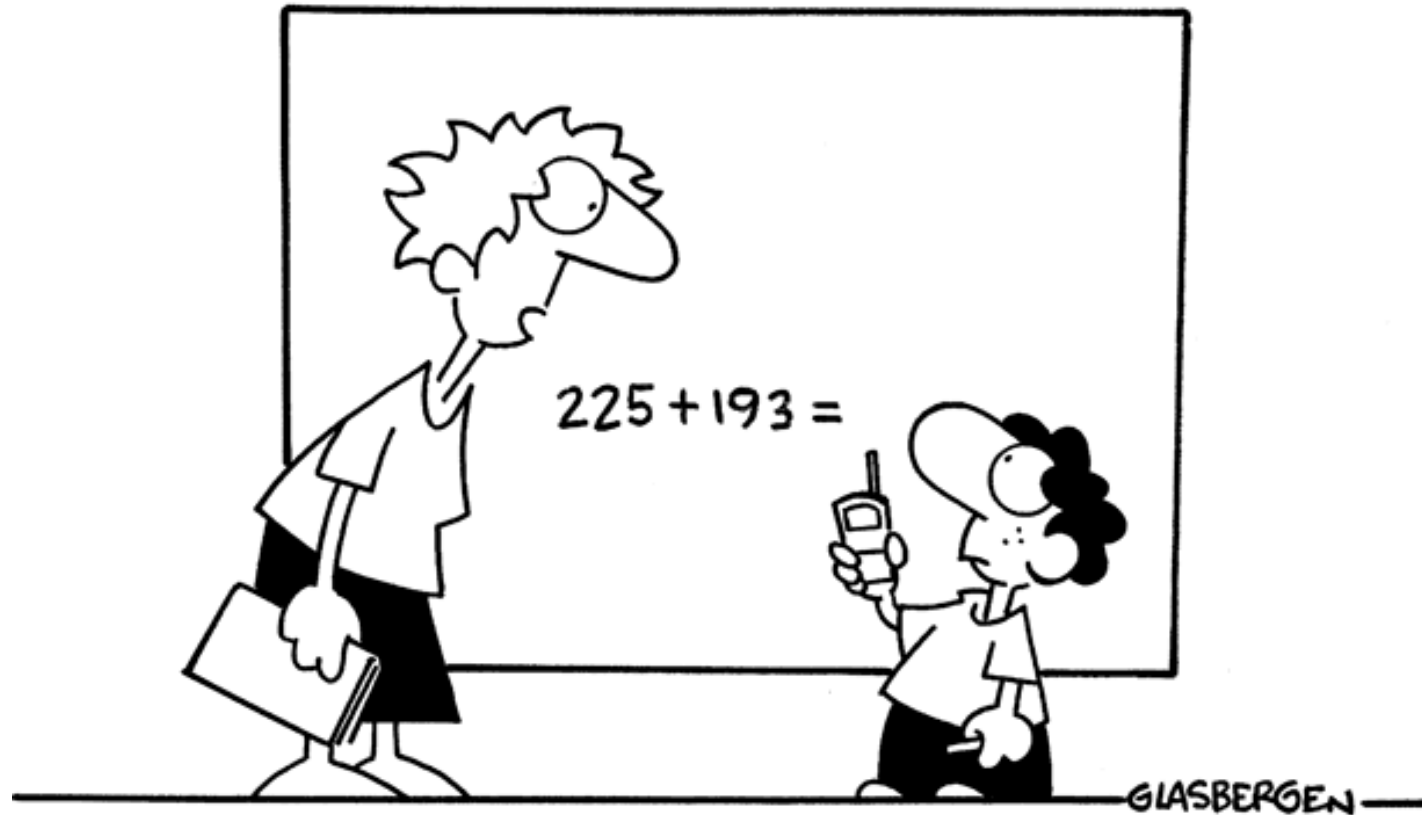
Total Monthly Rent Collected
– Operating Expenses

Operating income is usually the total amount of rent collected minus expenses. For the purpose of the Maintenance of Net Operating Income (MNOI) analysis, we will be using the **monthly** rental income collected.

Let's review a basic Maintenance of net operating Income (MNOI) calculation.....

Item G-1: MNOI Example Calculation

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“You have to solve this problem by yourself. You can’t call tech support.”

Let's look at a 4-unit complex example with the base year being 2015...

Item G-1: MNOI Example Calculation




\$5,600

Monthly revenue is 4 units
times \$1,400 = \$5,600



\$1,680

Monthly expenses are 30% of
revenue = \$1,680

**Net
Operating
Income =**  **\$3,920**

Monthly net operating income
(NOI) = \$3,920

Illustration of Fair Return Using the MNOI Standard

Fast forward to 2020: Rent has increased by **\$210** through AGA increases over the span of five years. The new **Maximum Allowable Rent** for each unit is **\$1,610**.



4 Unit Complex

Illustration of Fair Return Using the MNOI Standard


Maria has applied all of the Annual General Adjustment increases, but utility and management costs have also increased.



Monthly revenue for 4 units is
 $\$1,610 = \$6,440$



Monthly expenses are now 34%
of revenue = \$2,184

**Net
Operating
Income** =  **\$4,256**

Monthly net operating income
(NOI) = \$4,256

Illustration of Fair Return Using the MNOI Standard

The Hearing Examiner looks at the Net Operating Income in the Base Year (2015) for Maria's case.



$$\begin{array}{rcccl} \$3,920 & & & & \$4,508 \\ \text{2015 NOI} & + & \text{15\% of 2015 NOI} & = & \text{Fair Return} \\ & & \text{(CPI Increase)} & & \end{array}$$

- Fair net operating income is the base year net operating income (NOI) adjusted by the Consumer Price Index (CPI) increase since the base year.
- In this hypothetical example, the CPI increased by 15%. Therefore, the fair net operating income is \$3,920 increased by 15% for a total of \$4,508. To receive a Fair Return, the landlord should receive a monthly net operating income of \$4,508.

Illustration of Fair Return Using the MNOI Standard

Item G-1: MNOI Example Calculation

- Because expenses have increased by 30 percent (from \$1,680 to \$2,154) since 2015, Maria's monthly net operating income has increased by less than the percentage increase of the Consumer Price Index (CPI).
 - The Hearing Examiner has determined the Fair Return Net Operating Income (NOI) is \$4,508 (a \$252 difference from \$4,256).
 - To provide the landlord with a Net Operating Income (NOI) that generates a Fair Return, the Hearing Examiner determines each unit may receive up to a \$63 increase in the Maximum Allowable Rent (a total of \$252 for all 4 units).
 - The Hearing Examiner checks to see how much of a percentage the rent increase will result in for each tenant. In this example, the adjustment in the Maximum Allowable Rent would result in a 4 % rent increase for each tenant.
 - The board can adopt a cap on the allowed percent rent increase (e.g. 15%), which would phase in on a yearly basis the percentage change to the maximum allowable rent, in order to prevent rent shock for tenants.

How much (percentage) of inflation should be applied to the Net Operating Income (NOI)?

- In the previous example, the Hearing Examiner applied 100% of the change in the CPI. This equated to a 15% increase between 2015 and 2020.
- But, what if the Rent Board's policy was to apply 50%, 65% or 75% of the change in CPI?

Example of “Partial Indexing” Concept

Allowed Percentage Increase from a 15% CPI Increase	Percentage Increase to Net Operating Income	Actual Monthly Net Operating Income	Necessary Fair Return Net Operating Income	Total Rent Adjustment	Monthly Rent Increase Per Unit
50%	7.5%	\$4,256	\$4,214	\$0 – Landlord does not qualify	No Increase
65%	9.75%	\$4,256	\$4,302.20	\$88.20	\$22.05 per unit
75%	11.25%	\$4,256	\$4,361	\$105.00	\$26.25 per unit
100%	15.0%	\$4,256	\$4,508	\$252.00	\$63.00 per unit

City of Richmond Rent Program

Rent Adjustment Regulations: *Chapter 9 (Standards for Individual Maximum Allowable Rent Adjustments) Regulation 905 (Maintenance of Net Operating Income (MNOI) Fair Return Standard*

Chapter 9. Standards for Individual Maximum Allowable Rent Adjustments

905. Maintenance of Net Operating Income (MNOI) Fair Return Standard

A. Fair Return Standard

1. Presumption of Fair Base Year Net Operating Income. It shall be presumed that the net operating income received by the Landlord in the base year provided a Fair Return.

2. Fair Return. A Landlord has the right to obtain a net operating income equal to the base year net operating income adjusted by 100% of the percentage increase in the Consumer Price Index (CPI), since the base year. It shall be presumed this standard provides a Fair Return.

3. Base Year.

a. For the purposes of making Fair Return determinations pursuant to this section, the calendar year 2015 is the base year. The base year CPI shall be 2015, unless subsection (b) is applicable.

b. In the event that a determination of the allowable Rent is made pursuant to this section, if a subsequent petition is filed, the base year shall be the year that was considered as the "current year" in the prior petition.

4. Current Year

The "current year" shall be the calendar year preceding the application. The "current year CPI" shall be the annual CPI for the current year.

5. Adjustment of Base Year Net Operating Income.

Landlords or Tenants may present evidence to rebut the presumption that the base year net operating income provided a Fair Return. Grounds for rebuttal of the presumption shall be based on at least one of the following findings:

a. **Exceptional Expenses in the Base Year.** The Landlord's operating expenses in the base year were unusually high or low in comparison to other years. In such instances, adjustments may be made in calculating operating expenses in order that the base year operating expenses reflect average expenses for the property over a reasonable

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period of time. The following factors shall be considered in making such a finding:

- i. Extraordinary amounts were expended for necessary maintenance and repairs.
- ii. Maintenance and repair expenditures were exceptionally low so as to cause inadequate maintenance or significant deterioration in the quality of services provided.
- iii. Other expenses were unreasonably high or low notwithstanding the application of prudent business practices.

b. Exceptional Circumstances in the Base Year. The gross income during the base year was disproportionately low due to exceptional circumstances. In such instances, adjustments maybe made in calculating base year gross rental income consistent with the purposes of this chapter. The following factors shall be considered in making such a finding:

- i. If the gross income during the base year was lower than it might have been because some residents were charged reduced rent.
- ii. If the gross income during the base year was significantly lower than normal because of the destruction of the premises and/or temporary eviction for construction or repairs.
- iii. The pattern of rent increases in the years prior to the base year and whether those increases reflected increases in the CPI.
- iv. Base period rents were disproportionately low in comparison to the base period rents of comparable apartments in the City.
- v. Other exceptional circumstances.

6. Calculation of Net Operating Income. Net operating income shall be calculated by subtracting operating expenses from gross rental income.

e.a. Gross Rental Income.

- i. Gross rental income shall include:

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Gross rents calculated as gross scheduled rental income at one hundred percent occupancy and all other income or consideration received or receivable in connection with the use or occupancy of the Rental Unit, except as provided in Subparagraph (B) of this section.

~~If there are vacant units at the time a petition is filed the rent shall be calculated on the basis of average rents for comparable units in the property which have had vacancy increases within the past two years. If there are no comparable units in the property rental income for the vacant units shall be calculated on the basis of rents for recently established initial rents for comparable units in the City.~~

If there is a difference in the number of rental units between the base year and the current year, in making calculations of net operating income in the base year and the current year, the rental income and expenses for the same number of units shall be used in calculating the net operating income for both periods.

The purpose of this provision is to ensure that a petitioner is not requesting that the current fair net operating income reach a level which was provided in the base year by a larger number of units or is limited to a net operating income which was formerly provided by a smaller number of units.

If there are units that are vacant or owner-occupied at the time a petition is filed which were rented in the base year, for the purposes of the MNOI analysis a rental income for the unit shall be calculated on the basis of average rents for comparable units in the building which have been permitted vacancy decontrol increases within the past two years. If there are no comparable units in the property rental income for the vacant or owner occupied units, the rent shall be calculated on the basis of recently established initial rents for comparable units in the City. If there are units that were rented in the current year, which were vacant or owner-occupied in the base year, for the purposes of the MNOI analysis a rental income for the unit for the base year shall be calculated on the basis of average rents for comparable units in the building in the base year. If there are no comparable units in the property, rental income for the vacant or owner occupied units in the base year shall be calculated on the basis of base year rents for comparable units in the City. In the alternative, the Hearing

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Officer may use another reasonable methodology to insure compliance with the purposes of this subsection.

ii. Gross rental income shall not include:

Utility Charges for sub-metered gas, electricity or water;

Charges for refuse disposal, sewer service, and, or other services which are either provided solely on a cost pass-through basis and/or are regulated by state or local law;

Charges for laundry services; and

Storage charges.

~~4.b.~~ **Operating Expenses.** Operating expenses shall include the following:

~~i.~~ **Reasonable costs of operation and maintenance of the Rental Unit.** (including property insurance).

~~ii.~~

~~iii.i.~~ **Management expenses.** It shall be presumed that management expenses have increased between the base year and the current year by the percentage increase in rents or the CPI, whichever is greater, unless the level of management services has either increased or decreased significantly between the base year and the current year. This presumption shall also be applied in the event that management expenses changed from owner managed to managed by a third party or vice versa

~~iv.iii.~~ **Utility costs** except a utility where the consideration of the income associated with the provision of the utility service is regulated by state law and consideration of the costs associated with the provision of the utility service is preempted by state law or the income associated with the provision of the utility is not considered because it is recouped from the Tenants on a cost pass-through basis..

~~v.iv.~~ **Real property taxes and insurance**, subject to the limitation that property taxes attributable to an assessment in a year other than the base year or current year shall not be considered in calculating base year and/or current year operating expenses.

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~~vi.v.~~ **License, registration and other public fees** required by law to the extent these expenses are not otherwise paid or reimbursed by Tenants.

~~vii.vi.~~ **Landlord-performed labor** compensated at reasonable hourly rates. However, no Landlord-performed labor shall be included as an operating expense unless the Landlord submits documentation showing the date, time, and nature of the work performed. There shall be a maximum allowed under this provision of five percent (5%) of gross income unless the Landlord shows greater services were performed for the benefit of the residents. (HOURLY RATE PRESUMPTIONS TO BE INSERTED UPON ESTABLISHMENT OF CAPITAL IMPROVEMENT REGULATION)

~~viii.vii.~~ **Legal expenses.** Reasonable attorneys' fees and costs incurred in connection with successful good faith attempts to recover rents owing, successful good faith unlawful detainer actions not in derogation of applicable law, legal expenses necessarily incurred in dealings with respect to the normal operation of the Property, and reasonable costs incurred in obtaining a rent increase pursuant to Sections [11.100.070](#) of the Ordinance.

To the extent allowable legal expenses are not annually reoccurring and are substantial they shall be amortized over a five-year period, unless the Rent Board concludes that a different period is more reasonable. At the end of the amortization period, the allowable monthly rent shall be decreased by any amount it was increased because of the application of this provision.

~~ix.viii.~~ **The Amortized Costs of Capital ReplacementsImprovements.**

Operating expenses include the amortized costs of capital replacements improvements plus an interest allowance to cover the amortization of those costs. For purposes of this section a capital improvement shall be any improvement to a unit or property which materially adds to the value of the property, appreciably prolongs its useful life or adapts it to new use and has a useful life of more than one year and a direct cost of \$250.00 or more per unit affected. Allowances for capital improvements shall be subject to the following conditions:

The costs are amortized over the period set forth in Section ___ of this regulation and in no event over a period of less than thirty-six

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months.

The costs do not include costs incurred to bring the Rental Unit into compliance with a provision of the Richmond Municipal Code or state law where the original installation of the improvement was not in compliance with code requirements.

At the end of the amortization period, the allowable monthly rent shall be decreased by any amount it has increased due to the application of this provision.

The amortization period shall be in conformance with the following schedule adopted by the Rent Board unless it is determined that an alternate period is justified based on the evidence presented in the hearing.

(continued on following page)

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<u>Amortization of Capital Improvements</u>	
<u>In amortizing capital improvements, the following schedule shall be used to determine the amortization period of the capital improvements</u>	<u>Years</u>
<u>Appliances</u>	-
<u>Air Conditioners</u>	<u>10</u>
<u>Refrigerator</u>	<u>5</u>
<u>Stove</u>	<u>5</u>
<u>Garbage Disposal</u>	<u>5</u>
<u>Water Heater</u>	<u>5</u>
<u>Dishwasher</u>	<u>5</u>
<u>Microwave Oven</u>	<u>5</u>
<u>Washer/Dryer</u>	<u>5</u>
<u>Fans</u>	<u>5</u>
<u>Cabinets</u>	<u>10</u>
<u>Carpentry</u>	<u>10</u>
<u>Counters</u>	<u>10</u>
<u>Doors</u>	<u>10</u>
<u>Knobs</u>	<u>5</u>
<u>Screen Doors</u>	<u>5</u>
<u>Fencing and Security</u>	<u>5</u>
<u>Management</u>	<u>5</u>
<u>Tenant Assistance</u>	<u>5</u>
-	-
<u>Structural Repair and Retrofitting</u>	-
<u>Foundation Repair</u>	<u>10</u>
<u>Foundation Replacement</u>	<u>20</u>
<u>Foundation Bolting</u>	<u>20</u>
<u>Iron or Steel Work</u>	<u>20</u>
<u>Masonry-Chimney Repair</u>	<u>20</u>
<u>Shear Wall Installation</u>	<u>10</u>
<u>Electrical Wiring</u>	<u>10</u>
<u>Elevator</u>	<u>20</u>

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<u>Fencing</u>	-
<u>Chain</u>	<u>10</u>
<u>Block</u>	<u>10</u>
<u>Wood</u>	<u>10</u>
<u>Fire Systems</u>	
<u>Fire Alarm System</u>	<u>10</u>
<u>Fire Sprinkler System</u>	<u>20</u>
<u>Fire Escape</u>	<u>10</u>
-	-
<u>Flooring/Floor Covering</u>	-
<u>Hardwood</u>	<u>10</u>
<u>Tile and Linoleum</u>	<u>5</u>
<u>Carpet</u>	<u>5</u>
<u>Carpet Pad</u>	<u>5</u>
<u>Subfloor</u>	<u>10</u>
	-
<u>Fumigation Tenting</u>	<u>5</u>
<u>Furniture</u>	<u>5</u>
<u>Automatic Garage Door Openers</u>	<u>10</u>
-	-
<u>Gates</u>	-
<u>Chain Link</u>	<u>10</u>
<u>Wrought Iron</u>	<u>10</u>
<u>Wood</u>	<u>10</u>
<u>Glass</u>	-
<u>Windows</u>	<u>5</u>
<u>Doors</u>	<u>5</u>
<u>Mirrors</u>	<u>5</u>
<u>Heating</u>	-
<u>Central</u>	<u>10</u>
<u>Gas</u>	<u>10</u>
<u>Electric</u>	<u>10</u>
<u>Solar</u>	<u>10</u>
<u>Insulation</u>	<u>10</u>

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-	-
<u>Landscaping</u>	
<u>Planting</u>	<u>10</u>
<u>Sprinklers</u>	<u>10</u>
<u>Tree Replacement</u>	<u>10</u>
-	-
<u>Lighting</u>	
<u>Interior</u>	<u>10</u>
<u>Exterior</u>	<u>5</u>
-	-
<u>Locks</u>	<u>10</u>
<u>Mailboxes</u>	<u>10</u>
<u>Meters</u>	<u>10</u>
<u>Plumbing</u>	
<u>Fixtures</u>	<u>10</u>
<u>Pipe Replacement</u>	<u>10</u>
<u>Re-Pipe Entire Building</u>	<u>20</u>
<u>Shower Doors</u>	<u>5</u>
<u>Painting</u>	
<u>Interior</u>	<u>5</u>
<u>Exterior</u>	<u>5</u>
-	-
<u>Paving</u>	
<u>Asphalt</u>	<u>10</u>
<u>Cement</u>	<u>10</u>
<u>Decking</u>	<u>10</u>
<u>Plastering</u>	<u>10</u>
<u>Sump Pumps</u>	<u>10</u>
<u>Railings</u>	<u>10</u>
-	-
<u>Roofing</u>	
<u>Shingle/Asphalt</u>	<u>10</u>
<u>Built-up, Tar and Gravel</u>	<u>10</u>
<u>Tile</u>	<u>10</u>
<u>Gutters/Downspouts</u>	<u>10</u>

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-	-
<u>Security</u>	-
<u>Entry Telephone Intercom</u>	<u>10</u>
<u>Gates/Doors</u>	<u>10</u>
<u>Fencing</u>	<u>10</u>
<u>Alarms</u>	<u>10</u>
-	-
<u>Sidewalks/Walkways</u>	<u>10</u>
<u>Stairs</u>	<u>10</u>
<u>Stucco</u>	<u>10</u>
<u>Tilework</u>	<u>10</u>
<u>Wallpaper</u>	<u>5</u>
-	-
<u>Window Coverings</u>	
<u>Drapes</u>	<u>5</u>
<u>Shades</u>	<u>5</u>
<u>Screens</u>	<u>5</u>
<u>Awnings</u>	<u>5</u>
<u>Blinds/Miniblinds</u>	<u>5</u>
<u>Shutters</u>	<u>5</u>

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AMORTIZED COST TABLE (EXAMPLE)

Units
in Bldg 10

Cost	Annual Interest Rate	Amortization Period Years	Amortization Period Months	Total Principal & Interest Life-of Improvement	Total Interest Life-of Improvement	Monthly Amortized Cost	Annual Amortized Cost	Monthly Cost Per Unit
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Varying Amortization Periods – Same Interest Rate

\$50,000.00	7.00%	5	60	\$59,403.60	\$9,403.60	\$990.06	11880.72	\$99.01
\$50,000.00	7.00%	7	84	\$63,389.26	\$13,389.26	\$754.63	9055.61	\$75.46
\$50,000.00	7.00%	10	120	\$69,665.09	\$19,665.09	\$580.54	6966.51	\$58.05
\$50,000.00	7.00%	15	180	\$80,894.54	\$30,894.54	\$449.41	5392.97	\$44.94
\$50,000.00	7.00%	20	240	\$93,035.87	\$43,035.87	\$387.65	4651.79	\$38.76
\$50,000.00	7.00%	25	300	\$106,016.88	\$56,016.88	\$353.39	4240.68	\$35.34
\$50,000.00	7.00%	28	330	\$112,796.57	\$62,796.57	\$341.81	4101.69	\$34.18
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-

Same Amortization Period & Varying Interest Rates

-	-	-	-	-	-	-	-	-
\$50,000.00	5.0%	15	180	\$71,171.43	\$21,171.43	\$395.40	4744.76	\$39.54
\$50,000.00	6.0%	15	180	\$75,947.11	\$25,947.11	\$421.93	5063.14	\$42.19
\$50,000.00	7.0%	15	180	\$80,894.54	\$30,894.54	\$449.41	5392.97	\$44.94
\$50,000.00	8.0%	15	180	\$86,008.69	\$36,008.69	\$477.83	5733.91	\$47.78
\$50,000.00	9.0%	15	180	\$91,283.99	\$41,283.99	\$507.13	6085.60	\$50.71
\$50,000.00	10.0%	15	180	\$96,714.46	\$46,714.46	\$537.30	6447.63	\$53.73

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	%							
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~~x~~.ix. **Interest Allowance for Expenses that Are Amortized.** An interest allowance shall be allowed on the cost of amortized expenses. The allowance shall be the interest rate on the cost of the amortized expense equal to the "average rate" for thirty-year fixed rate on home mortgages plus two percent. The "average rate" shall be the rate Freddie Mac last published in its weekly Primary Mortgage Market Survey (PMMS) as of the date of the initial submission of the petition. In the event that this rate is no longer published, the Rent Board shall designate by regulation an index which is most comparable to the PMMS index.

~~xi~~.x. **Impact of Vacancy Decontrol on Rent Increases Based on Capital Improvements**

If a unit becomes vacant during the pendency of a schedule which provides for the expiration of increases for capital improvements and the unit qualifies for a vacancy increase pursuant to Civil Code section 1954.53, the capital improvements schedule shall terminate.

e.c. **Exclusions from Operating Expenses.** Operating expenses shall not include the following:

- i. Mortgage principal or interest payments or other debt service costs and costs of obtaining financing.
- ii. Any penalties, fees or interest assessed or awarded for violation of any provision of this chapter or of any other provision of law.
- iii. Land lease expenses.
- iv. Political contributions and payments to organizations or individuals which are substantially devoted to legislative lobbying purposes.
- v. Depreciation.

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- vi. Any expenses for which the Landlord has been reimbursed by any utility rebate or discount, Security Deposit, insurance settlement, judgment for damages, settlement or any other method or device.
- vii. Unreasonable increases in expenses since the base year.
- viii. Expenses associated with the provision of master-metered gas and electricity services.
- ix. Expenses which are attributable to unreasonable delays in performing necessary maintenance or repair work or the failure to complete necessary replacements. (For example if a roof replacement is unreasonably delayed, the full cost of the roof replacement would be allowed; however, if interior water damage occurred as a result of the unreasonable delay

f.d. Adjustments to Operating Expenses. Base year and/or current year operating expenses may be averaged with other expense levels for other years or amortized or adjusted by the CPI or to reflect levels that are normal for residential Rental Units or may otherwise be adjusted, in order to establish an expense amount for that item which most reasonably serves the objectives of obtaining a reasonable comparison of base year and current year expenses and providing a Fair Return. If the claimed operating expense levels are exceptionally high compared to prior expense levels and/or industry standards the Landlord shall have the burden of proof of demonstrating that they are reasonable and/or reflect recurring expense levels. Expenses which are exceptional and reasonable shall be amortized in order to achieve the objectives of this section.

g.e. Projections of Base Year Operating Expenses in the Absence of Actual Data

If the Landlord does not have base year operating expense data, it shall be presumed that operating expenses increased by the percentage increase in the CPI between the base year and the current year. This presumption is subject to the exception that specific operating expenses shall be adjusted by other amounts when alternate percentage adjustments are supported by a preponderance of evidence (such as data on changes in the rates of particular utilities or limitations on increases in property taxes.)

6.7. Allocation of Rent Increases

Rent increases authorized pursuant to this section shall be allocated as follows:

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- a. Rent increases for unit-specific capital improvements shall be allocated to that unit;
- b. Rent increases for building-wide or common area capital improvements shall be allocated equally among all units;
- c. Rent increases resulting from the Net Operating Income analysis shall be allocated equally among all units;
- d. Notwithstanding the subsections above, the hearing examiner or the Board, in the interests of justice, shall have the discretion to apportion the rent increases in a manner and to the degree necessary to ensure fairness. Such circumstances include, but are not limited to, units that are vacant or owner occupied.

7.8. Conditional Rent Adjustments for Proposed Capital Improvements

- a. In order to encourage necessary capital improvements, the Board allows a Landlord to petition for an upward rent adjustment based upon anticipated future expenses for capital improvements. The purpose of this procedure is to permit Landlords to seek advanced authorization for future rent adjustments based upon anticipated capital improvements. A petition under this Section should only be made for anticipated expenses that the Landlord intends to incur during the twelve month period following the date of final Board decision. This procedure should not be used for anticipated expenses for ordinary repairs and maintenance.
- b. If the petition is granted in whole or in part, the rent increase shall be postponed until such time as the capital improvements are made and an Addendum authorizing the increases is issued.
- c. No addendum shall be issued for such proposed capital improvements unless they are completed within ~~twelve~~ twenty four (24) months from the date of final decision granting the conditional rent adjustment, unless the Landlord obtains an additional addenda authorizing an extension of the time period to complete the capital improvement. ~~If supported by just cause such extensions shall be granted~~ Extensions may be granted due to reasonable delays in the completion of capital improvements as determined by the Hearing Examiner.

8.9. Any unit which received a vacancy rent increase pursuant to Civil Code section 1954.53 within ~~the two years~~ one year prior to the Fair Return application shall be ineligible for a

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rent increase for the portion of any rent increased based on the cost of proposed capital improvements.

9.10. Relationship of Individual Rent Adjustment to Annual General Adjustment

Any Individual Increase Adjustment established pursuant to this Section shall take into account the extent of any Annual General Adjustments the Landlord may be implementing, or otherwise be entitled to, at and during the time for which the Individual Adjustment is sought regarding the petitioning year, and the Individual Adjustment may be limited or conditioned accordingly.

If it is determined that the Landlord is not entitled to an Individual Adjustment, the Landlord may implement the full upcoming General Adjustment.

11. Limits to Annual Rent Adjustments Based on Maintenance of Net Operating Income Standard

A. Purpose

The purpose of this subsection (A) is to protect Tenants from substantial rent increases which are not affordable, and which may force such Tenants to vacate their homes and result in consequences contrary to the stated purposes of the Ordinance, namely, to maintain the diversity of the Richmond community, to preserve the public peace, health and safety, and advance the housing policies of the City with regard to low and fixed income persons, minorities, students, handicapped and the aged.

B. Rent Increase Limit

Notwithstanding any other provision of this regulation, the implementation of a Maximum Allowable Rent increase shall be limited ~~each year~~~~each year as follows:~~

~~_____ (e.g. 15%) to fifteen percent (15%) of the Maximum Allowable Rent~~ on the date the petition is filed, ~~or _____ (e.g. \$150 per month), whichever is greater.~~

~~On January 1st of each year beginning in February 2018, the \$_____ and/or _____% the 15% limitation shall be adjusted upward by 100% of the percentage increase in the Consumer Price Index, All Urban Consumers, for the San Francisco-Oakland-San Jose metropolitan area, less its shelter component, for the twelve month period ending on the preceding June 30th, rounded to the nearest dollar.~~

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If the amount of any rent increase granted under these regulations exceeds this limit, any portion in excess of the annual limit shall be deferred.

In subsequent years deferred amounts of the allowable rent increase may be implemented.

At the end of each year the deferred amount of the increase shall be calculated and an interest allowance shall be calculated based on the standard set forth in Section ___ of this regulation. One twelfth of the interest allowance shall be added on to full monthly increase authorized under the MNOI standard.

12. Constitutional Right to a Fair Return.

No provision of this regulation shall be applied so as to prohibit the Board from granting an individual rent adjustment that is demonstrated by the Landlord to be necessary to meet the requirements of this ordinance and/or constitutional Fair Return requirements.

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Chapter 9. Standards for Individual Maximum Allowable Rent Adjustments

905. Maintenance of Net Operating Income (MNOI) Fair Return Standard

A. Fair Return Standard

- 1. Presumption of Fair Base Year Net Operating Income.** It shall be presumed that the net operating income received by the Landlord in the Base Year provided a Fair Return.
- 2. Fair Return.** A Landlord has the right to obtain a net operating income equal to the Base Year net operating income adjusted by 100% of the percentage increase in the Consumer Price Index (CPI), since the Base Year. It shall be presumed this standard provides a Fair Return.
- 3. Base Year.**
 - a. For the purposes of making Fair Return determinations pursuant to this section, the calendar year 2015 is the Base Year. The Base Year CPI shall be 2015, unless subsection (b) is applicable.
 - b. In the event that a determination of the allowable Rent is made pursuant to this section, if a subsequent petition is filed, the Base Year shall be the year that was considered as the "current year" in the prior petition.

4. Current Year

The "current year" shall be the calendar year preceding the application. The "current year CPI" shall be the annual CPI for the current year.

5. Adjustment of Base Year Net Operating Income.

Landlords or Tenants may present evidence to rebut the presumption that the Base Year net operating income provided a Fair Return. Grounds for rebuttal of the presumption shall be based on at least one of the following findings:

- a. **Exceptional Expenses in the Base Year.** The Landlord's operating expenses in the Base Year were unusually high or low in comparison to other years. In such instances, adjustments may be made in calculating operating expenses in order that the Base Year operating expenses reflect average expenses for the property over a reasonable period of time. The following factors shall be considered in making

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such a finding:

- i. Extraordinary amounts were expended for necessary maintenance and repairs.
- ii. Maintenance and repair expenditures were exceptionally low so as to cause inadequate maintenance or significant deterioration in the quality of services provided.
- iii. Other expenses were unreasonably high or low notwithstanding the application of prudent business practices.

b. Exceptional Circumstances in the Base Year. The gross income during the Base Year was disproportionately low due to exceptional circumstances. In such instances, adjustments may be made in calculating Base Year gross rental income consistent with the purposes of this chapter. The following factors shall be considered in making such a finding:

- i. If the gross income during the Base Year was lower than it might have been because some residents were charged reduced rent.
- ii. If the gross income during the Base Year was significantly lower than normal because of the destruction of the premises and/or temporary eviction for construction or repairs.
- iii. The pattern of rent increases in the years prior to the Base Year and whether those increases reflected increases in the CPI.
- iv. Base period rents were disproportionately low in comparison to the base period rents of comparable apartments in the City.
- v. Other exceptional circumstances.

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6. Calculation of Net Operating Income. Net operating income shall be calculated by subtracting operating expenses from gross rental income.

a. **Gross Rental Income.**

i. Gross rental income shall include:

Gross rents calculated as gross scheduled rental income at one hundred percent occupancy and all other income or consideration received or receivable in connection with the use or occupancy of the Rental Unit, except as provided in Subparagraph (B) of this section.

If there is a difference in the number of rental units between the Base Year and the current year, in making calculations of net operating income in the Base Year and the current year, the rental income and expenses for the same number of units shall be used in calculating the net operating income for both periods.

The purpose of this provision is to ensure that a petitioner is not requesting that the current fair net operating income reach a level which was provided in the Base Year by a larger number of units or is limited to a net operating income which was formerly provided by a smaller number of units.

If there are units that are vacant or owner-occupied at the time a petition is filed which were rented in the Base Year, for the purposes of the MNOI analysis a rental income for the unit shall be calculated on the basis of average rents for comparable units in the building which have been permitted vacancy decontrol increases within the past two years. If there are no comparable units in the property rental income for the vacant or owner occupied units, the rent shall be calculated on the basis of recently established initial rents for comparable units in the City. If there are units that were rented in the current year, which were vacant or owner-occupied in the Base Year, for the purposes of the MNOI analysis a rental income for the unit for the Base Year shall be calculated on the basis of average rents for comparable units in the building in the Base Year. If there are no comparable units in the property, rental income for the vacant or owner occupied units in the Base Year shall be calculated on the basis of Base

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Year rents for comparable units in the City. In the alternative, the Hearing Examiner may use another reasonable methodology to insure compliance with the purposes of this subsection.

ii. Gross rental income shall not include:

Utility Charges for sub-metered gas, electricity or water;

Charges for refuse disposal, sewer service, and, or other services which are either provided solely on a cost pass-through basis and/or are regulated by state or local law;

Charges for laundry services; and

Storage charges.

b. **Operating Expenses.** Operating expenses shall include the following:

i. **Reasonable costs of operation and maintenance of the Rental Unit.**

ii. **Management expenses.** It shall be presumed that management expenses have increased between the Base Year and the current year by the percentage increase in rents or the CPI, whichever is greater, unless the level of management services has either increased or decreased significantly between the Base Year and the current year. This presumption shall also be applied in the event that management expenses changed from owner managed to managed by a third party or vice versa

iii. **Utility costs** except a utility where the consideration of the income associated with the provision of the utility service is regulated by state law and consideration of the costs associated with the provision of the utility service is preempted by state law or the income associated with the provision of the utility is not considered because it is recouped from the Tenants on a cost pass-through basis..

iv. **Real property taxes and insurance,** subject to the limitation that property taxes attributable to an assessment in a year other than the Base Year or current year shall not been considered in calculating Base Year and/or current year operating expenses.

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- v. **License, registration and other public fees** required by law to the extent these expenses are not otherwise paid or reimbursed by Tenants.
- vi. **Landlord-performed labor** compensated at reasonable hourly rates. However, no Landlord-performed labor shall be included as an operating expense unless the Landlord submits documentation showing the date, time, and nature of the work performed. There shall be a maximum allowed under this provision of five percent (5%) of gross income unless the Landlord shows greater services were performed for the benefit of the residents (HOURLY RATE PRESUMPTIONS TO BE INSERTED UPON ESTABLISHMENT OF CAPITAL IMPROVEMENT REGULATION).
- vii. **Legal expenses.** Reasonable attorneys' fees and costs incurred in connection with successful good faith attempts to recover rents owing, successful good faith unlawful detainer actions not in derogation of applicable law, legal expenses necessarily incurred in dealings with respect to the normal operation of the Property, and reasonable costs incurred in obtaining a rent increase pursuant to Sections 11.100.070 of the Ordinance.

To the extent allowable legal expenses are not annually reoccurring and are substantial they shall be amortized over a five-year period, unless the Rent Board concludes that a different period is more reasonable. At the end of the amortization period, the allowable monthly rent shall be decreased by any amount it was increased because of the application of this provision.
- viii. **The Amortized Costs of Capital Improvements.** Operating expenses include the amortized costs of capital improvements plus an interest allowance to cover the amortization of those costs. For purposes of this section a capital improvement shall be any improvement to a unit or property which materially adds to the value of the property, appreciably prolongs its useful life or adapts it to new use and has a useful life of more than one year and a direct cost of \$250.00 or more per unit affected. Allowances for capital improvements shall be subject to the following conditions:

The costs are amortized over the period set forth in Section (A)(6)(b)(viii) of this regulation and in no event over a period of less than thirty-six (36) months.

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The costs do not include costs incurred to bring the Rental Unit into compliance with a provision of the Richmond Municipal Code or state law where the original installation of the improvement was not in compliance with code requirements.

At the end of the amortization period, the allowable monthly rent shall be decreased by any amount it has increased due to the application of this provision.

The amortization period shall be in conformance with the following schedule adopted by the Rent Board unless it is determined that an alternate period is justified based on the evidence presented in the hearing.

(continued on following page)

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Rent Adjustment Regulations: *Chapter 9 (Standards for Individual Maximum Allowable Rent Adjustments) Regulation 905 (Maintenance of Net Operating Income (MNOI) Fair Return Standard*

Amortization of Capital Improvements	
In amortizing capital improvements, the following schedule shall be used to determine the amortization period of the capital improvements	Years
<i>Appliances</i>	
Air Conditioners	10
Refrigerator	5
Stove	5
Garbage Disposal	5
Water Heater	5
Dishwasher	5
Microwave Oven	5
Washer/Dryer	5
Fans	5
Cabinets	10
Carpentry	10
Counters	10
Doors	10
Knobs	5
Screen Doors	5
Fencing and Security	5
Management	5
Tenant Assistance	5
<i>Structural Repair and Retrofitting</i>	
Foundation Repair	10
Foundation Replacement	20
Foundation Bolting	20
Iron or Steel Work	20
Masonry-Chimney Repair	20
Shear Wall Installation	10
Electrical Wiring	10
Elevator	20

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<i>Fencing</i>	
Chain	10
Block	10
Wood	10
<i>Fire Systems</i>	
Fire Alarm System	10
Fire Sprinkler System	20
Fire Escape	10
<i>Flooring/Floor Covering</i>	
Hardwood	10
Tile and Linoleum	5
Carpet	5
Carpet Pad	5
Subfloor	10
Fumigation Tenting	5
Furniture	5
Automatic Garage Door Openers	10
<i>Gates</i>	
Chain Link	10
Wrought Iron	10
Wood	10
<i>Glass</i>	
Windows	5
Doors	5
Mirrors	5
<i>Heating</i>	
Central	10
Gas	10
Electric	10
Solar	10
Insulation	10

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<i>Landscaping</i>	
Planting	10
Sprinklers	10
Tree Replacement	10
<i>Lighting</i>	
Interior	10
Exterior	5
Locks	10
Mailboxes	10
Meters	10
<i>Plumbing</i>	
Fixtures	10
Pipe Replacement	10
Re-Pipe Entire Building	20
Shower Doors	5
<i>Painting</i>	
Interior	5
Exterior	5
<i>Paving</i>	
Asphalt	10
Cement	10
Decking	10
Plastering	10
Sump Pumps	10
Railings	10
<i>Roofing</i>	
Shingle/Asphalt	10
Built-up, Tar and Gravel	10
Tile	10
Gutters/Downspouts	10

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<i>Security</i>	
Entry Telephone Intercom	10
Gates/Doors	10
Fencing	10
Alarms	10
Sidewalks/Walkways	10
Stairs	10
Stucco	10
Tilework	10
Wallpaper	5
<i>Window Coverings</i>	
Drapes	5
Shades	5
Screens	5
Awnings	5
Blinds/Miniblinds	5
Shutters	5

- ix. **Interest Allowance for Expenses that Are Amortized.** An interest allowance shall be allowed on the cost of amortized expenses. The allowance shall be the interest rate on the cost of the amortized expense equal to the "average rate" for thirty-year fixed rate on home mortgages plus two percent. The "average rate" shall be the rate Freddie Mac last published in its weekly Primary Mortgage Market Survey (PMMS) as of the date of the initial submission of the petition. In the event that this rate is no longer published, the Rent Board shall designate by regulation an index which is most comparable to the PMMS index.
- x. **Impact of Vacancy Decontrol on Rent Increases Based on Capital Improvements**

If a unit becomes vacant during the pendency of a schedule which provides for the expiration of increases for capital improvements and the unit qualifies for a vacancy increase pursuant to Civil Code section 1954.53, the capital improvements schedule shall terminate.

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- c. **Exclusions from Operating Expenses.** Operating expenses shall not include the following:
- i. Mortgage principal or interest payments or other debt service costs and costs of obtaining financing.
 - ii. Any penalties, fees or interest assessed or awarded for violation of any provision of this chapter or of any other provision of law.
 - iii. Land lease expenses.
 - iv. Political contributions and payments to organizations or individuals which are substantially devoted to legislative lobbying purposes.
 - v. Depreciation.
 - vi. Any expenses for which the Landlord has been reimbursed by any utility rebate or discount, Security Deposit, insurance settlement, judgment for damages, settlement or any other method or device.
 - vii. Unreasonable increases in expenses since the Base Year.
 - viii. Expenses associated with the provision of master-metered gas and electricity services.
 - ix. Expenses which are attributable to unreasonable delays in performing necessary maintenance or repair work or the failure to complete necessary replacements. (For example if a roof replacement is unreasonably delayed, the full cost of the roof replacement would be allowed; however, if interior water damage occurred as a result of the unreasonable delay
- d. **Adjustments to Operating Expenses.** Base Year and/or current year operating expenses may be averaged with other expense levels for other years or amortized or adjusted by the CPI or to reflect levels that are normal for residential Rental Units or may otherwise be adjusted, in order to establish an expense amount for that item which most reasonably serves the objectives of obtaining a reasonable comparison of Base Year and current year expenses and providing a Fair Return. If the claimed operating expense levels are exceptionally high compared to prior expense levels and/or industry standards the Landlord shall have the burden of proof of demonstrating that they are reasonable and/or reflect recurring expense levels. Expenses which are exceptional and reasonable shall be amortized in

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order to achieve the objectives of this section.

e. Projections of Base Year Operating Expenses in the Absence of Actual Data

If the Landlord does not have Base Year operating expense data, it shall be presumed that operating expenses increased by the percentage increase in the CPI between the Base Year and the current year. This presumption is subject to the exception that specific operating expenses shall be adjusted by other amounts when alternate percentage adjustments are supported by a preponderance of evidence (such as data on changes in the rates of particular utilities or limitations on increases in property taxes.)

7. Allocation of Rent Increases

Rent increases authorized pursuant to this section shall be allocated as follows:

- a. Rent increases for unit-specific capital improvements shall be allocated to that unit;
- b. Rent increases for building-wide or common area capital improvements shall be allocated equally among all units;
- c. Rent increases resulting from the Net Operating Income analysis shall be allocated equally among all units;
- d. Notwithstanding the subsections above, the hearing examiner or the Board, in the interests of justice, shall have the discretion to apportion the rent increases in a manner and to the degree necessary to ensure fairness. Such circumstances include, but are not limited to, units that are vacant or owner occupied.

8. Conditional Rent Adjustments for Proposed Capital Improvements

- a. In order to encourage necessary capital improvements, the Board allows a Landlord to petition for an upward rent adjustment based upon anticipated future expenses for capital improvements. The purpose of this procedure is to permit Landlords to seek advanced authorization for future rent adjustments based upon anticipated capital improvements. A petition under this Section should only be made for anticipated expenses that the Landlord intends to incur during the twelve month period following the date of final Board decision. This procedure should not be used for anticipated expenses for ordinary repairs and maintenance.

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- b. If the petition is granted in whole or in part, the rent increase shall be postponed until such time as the capital improvements are made and an Addendum authorizing the increases is issued.
 - c. No addendum shall be issued for such proposed capital improvements unless they are completed within twenty four (24) months from the date of final decision granting the conditional rent adjustment, unless the Landlord obtains an additional addenda authorizing an extension of the time period to complete the capital improvement. Extensions may be granted due to reasonable delays in the completion of capital improvements as determined by the Hearing Examiner.
9. Any unit which received a vacancy rent increase pursuant to Civil Code section 1954.53 within one year prior to the Fair Return application shall be ineligible for a rent increase for the portion of any rent increased based on the cost of proposed capital improvements.

10. Relationship of Individual Rent Adjustment to Annual General Adjustment

Any Individual Increase Adjustment established pursuant to this Section shall take into account the extent of any Annual General Adjustments the Landlord may be implementing, or otherwise be entitled to, at and during the time for which the Individual Adjustment is sought regarding the petitioning year, and the Individual Adjustment may be limited or conditioned accordingly.

If it is determined that the Landlord is not entitled to an Individual Adjustment, the Landlord may implement the full upcoming General Adjustment.

11. Limits to Annual Rent Adjustments Based on Maintenance of Net Operating Income Standard

A. Purpose

The purpose of this subsection (A) is to protect Tenants from substantial rent increases which are not affordable, and which may force such Tenants to vacate their homes and result in consequences contrary to the stated purposes of the Ordinance, namely, to maintain the diversity of the Richmond community, to preserve the public peace, health and safety, and advance the housing policies of the City with regard to low and fixed income persons, minorities, students, handicapped and the aged.

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B. Rent Increase Limit

Notwithstanding any other provision of this regulation, the implementation of a Maximum Allowable Rent increase shall be limited each year to fifteen percent (15%) of the Maximum Allowable Rent on the date the petition is filed.

If the amount of any rent increase granted under these regulations exceeds this limit, any portion in excess of the annual limit shall be deferred.

In subsequent years deferred amounts of the allowable rent increase may be implemented.

At the end of each year the deferred amount of the increase shall be calculated and an interest allowance shall be calculated based on the standard set forth in Section (A)(6)(b)(ix) of this regulation. One twelfth (1/12) of the interest allowance shall be added on to full monthly increase authorized under the MNOI standard.

12. Constitutional Right to a Fair Return.

No provision of this regulation shall be applied so as to prohibit the Board from granting an individual rent adjustment that is demonstrated by the Landlord to be necessary to meet the requirements of this ordinance and/or constitutional Fair Return requirements.

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City of Richmond Rent Program
Summary of Community Feedback
December 2017 Community Workshops Regarding Setting Standards for Changes in the Maximum Rent

Increases in Operating Expenses, Fair Return Standards

1. What do you think are the most important factors to consider in setting a fair return standard?

- One factor includes the high costs that Landlords must pay to improve their rental units and keep them up to code.
- Units damaged by previous tenants are another financial burden that a landlord has to face.
- Insurance costs to landlords are increasing due to the ability to not add addendum to the current lease (Tenant insurance).
- Considering mortgage payments is an important factor.
- Due to some of their rental units having large families, many Landlords have seen an increase in their utility bills.
- Property taxes have also seen a hike for many Landlords in the previous years.
- Consider the fees that Landlords must pay to conduct business in the City of Richmond (Business License, Fire Prevention, Rental Inspection, and Rental Housing fee).
- Depending on the number of units that a building has, there is a scheduled time as to when they must refinance the building.
- Consider the costs for legal services for issues with tenants.
- Landlords feel that the Annual NOI should stay above the AGI.

2. What did you like or dislike about any of the fair return models presented?

- Landlords disliked that there was no transparent remedial courses of action regarding tenant and Landlord responsibilities for claims and actions.
- A couple of Landlords did not like the ROI model presented and that was primarily due to them having trust issues with the Rent Program/Board.
- Landlords thought the MNOI model was ok but had questions in regards to excluding the debt service and the rent rollback.
- The ROI model was also questioned and some Landlords wanted to know what exactly was the investment and if it included mortgage payments.

3. Please share any additional comments or questions in the space below:

- A question arose that if a Landlord were to create a rule requiring renter's insurance, would that be considered a "rent increase"?

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City of Richmond Rent Program
Summary of Community Feedback
December 2017 Community Workshops Regarding Setting Standards for Changes in the Maximum Rent

- Many Landlords voiced their disapproval of the fact that tenants were allowed to add more tenants into their unit and the Landlord could not increase the rent automatically.
- The ROV model also had a few questions in regard to some of the wording used such as the meaning of “value”.