

# AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: May 16, 2018

Final Decision Date Deadline: May 16, 2018

**STATEMENT OF THE ISSUE:** Section 11.100.060 (l)(1) of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance ("Rent Ordinance") provides that "All Landlords shall pay a business license fee if required by the Richmond Municipal Code plus a Residential Rental Housing Fee." The Rent Program budget is funded by the Rental Housing Fee. At the April 18, 2018 Regular Meeting, the Rent Board directed staff to draft a policy report regarding a possible pass-through of a portion of the Rental Housing Fee to Tenants. To that end, the Executive Director has prepared a policy report for the Board's consideration.

## 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:** RECEIVE a memo from the Executive Director regarding the adoption of a policy permitting a partial pass through of the Rental Housing Fee to be paid by Tenants over a 12-month period and PROVIDE direction to staff – Rent Program (Nicolas Traylor 620-6564).

AGENDA ITEM NO:  
**H-3.**



# AGENDA REPORT

**DATE:** May 16, 2018

**TO:** Chair Gray and Members of the Rent Board

**FROM:** Nicolas Traylor, Executive Director

**SUBJECT:** POLICY CONSIDERATIONS FOR A RENTAL HOUSING FEE PASS-THROUGH

## **STATEMENT OF THE ISSUE:**

Section 11.100.060 (l)(1) of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance (“Rent Ordinance”) provides that “All Landlords shall pay a business license fee if required by the Richmond Municipal Code plus a Residential Rental Housing Fee.” The Rent Program budget is funded by the Rental Housing Fee. At the April 18, 2018 Regular Meeting, the Rent Board directed staff to draft a policy report regarding a possible pass-through of a portion of the Rental Housing Fee to Tenants. To that end, the Executive Director has prepared a policy report for the Board’s consideration.

## **RECOMMENDED ACTION:**

RECEIVE a memo from the Executive Director regarding the adoption of a policy permitting a partial pass through of the Rental Housing Fee to be paid by Tenants over a 12-month period and PROVIDE direction to staff – Rent Program (Nicolas Traylor 620-6564).

## **FISCAL IMPACT:**

The tasks associated with implementing a partial pass-through of the Residential Housing Fee (hereinafter, “Fee”) would likely increase overall program expenditures. The estimated cost to administer a pass-through of the Fee is expected to be at least 0.25 full time employee (FTE) in a counseling position. Based on a salary of a Rent Program Services Analyst, 0.25FTE would amount to a \$32,000 increase in salary and benefit costs. This \$32,000 cost estimate is based on the costs associated with reviewing and processing pass-through notices, addressing eligibility disputes, handling petitions based on unauthorized fees/charges, and assisting tenants who may have received a notice of termination of tenancy resulting from non-payment of the pass-through Fee. Such an increase would need to be offset by either an increase in the Fee

of ~\$4/unit or a reduction in other key agency activities, namely compliance, outreach, and rent registration. Reducing resources for outreach and rent registration would negatively impact overall compliance with both the Rent Ordinance itself as well as collection of the Fee.

**DISCUSSION:**

Background

Most rent stabilization programs cover their operating costs by charging an annual per-unit fee to landlords covered by the program. The Fee proposed for the City of Richmond for the 2018 – 2019 Fiscal Year is \$207 for fully covered units which equates to \$17.25 a month. If a pass-through policy is adopted it would only apply to fully covered units, since Landlords of partially covered units could presumably increase the rent to cover the cost of the Fee. Some cities allow landlords to charge the tenant part of this fee, typically half, in addition to the allowable rent ceiling. This agenda report will examine the policy arguments in favor of and against establishing such a pass-through policy.

Fee Pass-Through Policy Considerations

1. Arguments Against Pass-Through

A Pass-Through of the Fee would likely increase staff costs potentially leading to an increase in the Rental Housing Fee (and the amount that is passed on to Tenants)

Implementing a pass-through policy would increase staff costs and therefore the Fee itself. The impact is two-fold. First, the increase in staff costs would likely increase the Fee in future years and would require shifting current budgeted resources away from integral activities, such as compliance/enforcement. Preliminary estimates suggest it will take between 0.25 FTE to 0.5 FTE to administer the pass-through. This would amount to an additional ~\$4 to \$8 in annual Fees per unit. Tenants would therefore also pay an additional amount if a portion of the Fee (e.g. 50%) were passed on to them.

Administering a pass-through would add complexity to counseling and lead to unnecessary disputes

Beyond the monetary and transactional costs associated with administering a pass-through of the Rental Housing Fee, a pass-through adds an additional layer of complexity to counseling, which would lead to an increase in a counselor’s workload. An increase in workload would include, but would not be limited to the following: determining whether or not the pass-through of the Fee applies to a particular tenancy, counseling Landlords who mistakenly attempt to evict for non-payment of the Tenant’s portion of the Fee, and counseling Tenants who receive notices of termination of tenancies for failing to pay

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their portion of the Fee. Some Landlords may also (unlawfully) deduct pass-through Fees not paid by the Tenants from the security deposit, leading to an increase in petitions to recover unlawfully held security deposits, or mistakenly include the pass-through Fee in the calculation of the Maximum Allowable Rent, resulting in increased counseling cases to resolve those miscalculations.

At this time any policy that diminishes resources targeted for compliance could negatively impact both Landlords and Tenants

Since the Rent Program has only collected 60% of the potential Fees to date, the top priority for the agency at this time is increasing compliance with the Fee. Implementing a pass-through policy at this time would diminish resources needed for compliance. Once the Rent Program has reached compliance rates comparable to established Rent Programs (90%-95% compliance rate) and fewer resources are needed for compliance, a pass-through may be a policy for the Rent Board to reconsider. Shifting resources away from compliance, outreach and rent registration, diminishes the Rent Program's ability to collect the Fees necessary to fund the Program, which could potentially increase the Fee in future years.

There are avenues in place for Landlords who are not receiving a Fair Return: An MNOI rent increase petition and other Landlord rent adjustment petitions

In the case of landlords who have unusually high costs (including the cost of the Rental Housing Fee), the Rent Program regulations enable landlords to apply for an Individual Rent Adjustment for Maintenance of Net Operating Income. If the fee of \$207 per unit per year contributes to an inability to maintain the same inflation-adjusted Net Operating Income (NOI) as the owner had in 2015, they will receive an increase in the Maximum Allowable Rent level sufficient to cover that cost as well as any other increased costs that result in a decrease in NOI. In the case of landlords who charged a rent significantly below market in the Base Year, the Rent Board may adopt regulations that enable these landlords to apply for an Individual Rent Adjustment that will adjust their Base Rent taking into consideration 2015 market rents for the affected units.

The Fee may be tax-deductible for Landlords

Expenses related to operating a residential rental business, such as the Rental Housing Fee, are typically tax deductible, which provides an additional means for offsetting the cost of the Fee. On the other hand, Tenants cannot deduct the pass-through of the Fee on their taxes.

Although there is a possibility that the Costa-Hawkins

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With vacancy decontrol in effect Landlords can recover Fees through vacancy rent increases

Rental Act will be repealed in November of this year, Landlords currently have the ability to reset rents to market following a voluntary vacancy or complete turnover of original occupants. This allows the Fee paid by the Landlord to be offset by a vacancy rent increase(s). If the Costa Hawkins Rental Act is repealed and the Rent Board decided to adopt "full rent control" or vacancy control, a pass-through of the Rental Housing Fee would arguably be more appropriate since Landlords would not be able to reset rents between tenancies.

Eviction related concerns: Unlawful attempts to evict due to non-payment of the Fee by the Tenant

Another concern is that some Tenants may be served a 3-day notice to pay rent or quit for not paying the Fee. While the Fee is not considered Rent (it is a surcharge) and is not part of the Maximum Allowable Rent level, some Landlords may not know this and may attempt to evict a Tenant for nonpayment of the Fee.

Landlords and Tenants could incur legal cost associated with attempts to evict for failure to pay the pass-through

Both Landlords and Tenants would likely incur financial burdens associated with litigating such non-payment cases. While some Tenants may receive legal assistance or representation, other Tenants may fail to access legal representation, and may be unable to navigate the complexities of the eviction process. For instance, some tenants may fail to timely respond to an unlawful detainer or respond to the unlawful detainer but miss their court dates, either of which would result in a default judgement and eviction.

Some Tenants may just move out rather than fight an eviction

Some Tenants, especially undocumented tenants may just vacate in fear of having to expose themselves by going to court.

Increased outreach to mitigate unlawful pass-through related eviction attempts add to Program costs

To address this situation, the Rent Program would need to engage in robust outreach and education for both Landlord and Tenants to help mitigate such unlawful attempts to evict due to non-payment of the pass-through Fee. This additional outreach would add to the costs of administering the pass-through, which as mentioned before either increases the budget and therefore the Rental Housing Fee or takes away resources from other key activities such as compliance.

Establishing a pass-through policy may lead to

Implementing the pass-through of Fees may lead to confusion concerning whether or not the Fee is part of the Maximum Allowable Rent level. The Maximum Allowable

miscalculations of the Maximum Allowable Rent which would increase the need to devote staff time and resources to resolving such disputes

Rent level is calculated by multiplying the base or initial rent by the Annual General Adjustment. The miscalculation of the Maximum Allowable Rent would occur if a Landlord included the pass-through Fee amount in the calculation of the Maximum Allowable Rent. For example, if the pass-through Fee were \$8 per month and a Tenant's Maximum Allowable Rent were \$1000, landlords might apply the Annual General Adjustment percentage (e.g. 3%) to \$1008 instead of to \$1000. This minor miscalculation could lead to an increased need for Program staff to assist tenants and landlords with correcting the calculation and resolving rent overcharges that resulted from the miscalculation. This would increase the need for counseling and mediation resources, and would likely lead to increased petitions and hearings. The impact would result in an increase in staff costs, which would need to be offset by an increase in the Fee or reduction in other key services.

As a "start-up," the Richmond Rent Program should not be devoting its limited organizational bandwidth to implementing a complex administrative task that is difficult to enforce

In Berkeley, where a limited pass-through policy for pre-1996 tenancies has been in place for many years and where robust outreach and education on their pass-through is done, Berkeley's housing counselors still devote a notable portion of their time dealing with the aftermath of, and correcting for MAR miscalculations. The Berkeley Rent Stabilization Program has been around for over 40 years and has a staff of over 20 FTE (and a budget of over \$5,000,000 annually). The Richmond Rent Program has half the budget and staff compared to Berkeley and is a start-up with compliance deficiencies one would expect a new rent control program to have. Additionally the Richmond Rent Program has many organizational programs to still under development (e.g. rent registration, compliance projects and the hearings program). Adding an additional administrative program that does not significantly increase levels of compliance but rather, increases staffing costs/burdens, is not advisable at this time and works against our primary mission.

An unenforceable pass-through policy may only lead to increased conflict between Landlords and Tenants

As a surcharge in addition to the rent, the Landlord is not entitled to evict for non-payment, so the Fee could be subject to resistance from some Tenants. One could easily imagine the lack of enforceability could lead to a rising the level of conflict between Landlords and Tenants, with the Rent Program in the middle of having to mediate or assist in resolving a problem that it helped create.

2. Arguments To Support A Limited Pass-Through

A pass-through of \$8.63 is presumably affordable to many Tenant households

All tenants benefit from the Rent Program and its services and presumably many would be able to afford to pay an additional \$8.63 a month. The charge will increase tenant awareness of the program and give tenants a stake in keeping program costs down. While the Rent Board could establish a policy exempting low-income Tenants from paying the pass-through, this could create a disincentive to renting to low-income Tenants. It is also important to note that the pass-through would likely not apply to Section 8 tenancies in accordance with HUD regulations. Additionally, although any increase in rent for a low-income tenant can lead to a financial strain, it is currently unknown whether an \$8-\$9 per monthly surcharge would actually lead to the kind of housing instability that could cause displacement or financial suffering.

A pass-through of the Fee is about fairness when it comes to funding the Rent Program since Tenants benefit significantly from rent controls and eviction protections

Another argument for allowing a limited pass-through is promoting fairness. The primary beneficiaries of rent controls and eviction protections are Tenants. Without rent controls and eviction protections, Tenants in Richmond were vulnerable to the upward swings in the market, which resulted in many experiencing rent shock and rent increases that far outweighed an \$8.63 increase in monthly expenses. An \$8.63 increase in monthly expenses for tenants is a small price to pay for the numerous important services provided by the Rent Program.

It is worth the cost of administering a pass-through because fairness in funding the Program only strengthens and protects the Rent Ordinance

Although it may potentially move resources away from other Program activities or cause the Fee to increase, the cost of administering the pass-through may be worth it. With time, the administrative cost associated with implementing the pass-through would be incorporated into the budget to share the cost of funding the Rent Program between Landlords and Tenants equally. This concept could insulate the agency from scrutiny and lead to more Landlord support for the Program.

### Recommendation

While staff supports the concept of sharing the costs of the Rent Program between Landlords and Tenants, at this time administering a pass-through policy may not be in the interest of the Rent Program. The strongest argument against a pass-through at this particular time is that it would increase Program costs due to its complexity, thereby detracting from key Program activities, namely compliance and outreach, which during the startup period is the most important priority for the agency.

Agency priorities aside, there are additional compelling arguments against a pass-through. Those arguments include that Richmond Landlords currently operate under vacancy decontrol, which presumably provides adequate opportunities for Landlords to use vacancy/market rent increases to offset the Fee. Furthermore, Landlords who are not receiving a Fair Return can include payment of the Fee as an operating expense as a part of a Maintenance of Net Operating Income rent increase petition.

Additionally, the Fee may be tax-deductible, which provides Landlord another avenue for offsetting the cost of the Fee. Tenants would not be able to deduct a pass-through of the Fee from their taxes.

From an administrative perspective, establishing a pass-through policy would be complicated to administer, would add to Program costs and potentially drive up the Fee. As has happened in other jurisdictions that allow for a pass-through of the Fee, some Landlords will mistakenly calculate the pass-through surcharge as part of the Maximum Allowable Rent, resulting in Tenants being overcharged and leading to more staff resources (counseling, mediation, unnecessary excessive rent petitions being filed) being devoted to assist Landlords and Tenants with correcting miscalculations and or mediating rent overcharge refunds.

Staff recommends that the decision to implement a pass-through policy should be reconsidered in the future, if the following conditions apply:

- 1) If Costa-Hawkins or Vacancy Decontrol is repealed: This November, California voters may decide to repeal the Costa Hawkins Rental Act, which would allow the Richmond Rent Board to implement “full rent control” or vacancy control. If and when vacancy decontrol is prohibited and Landlords were unable to reset the rent to market between tenancies, a pass-through of the Rental Housing Fee should be brought back to the Board for serious reconsideration. Even if Costa Hawkins remains the law of the land, the Rent Board- could always reconsider a pass-through policy, when doing so would not detract from our fundamental need to achieve higher compliance with the Rental Housing Fee.
- 2) Once the Richmond Rent Program has achieved levels of compliance comparable to established rent control cities, a pass-through policy would not detract from our primary start-up goal of achieving compliance with the Rental Housing Fee.

Policy Recommendations If and When the Board Decides to Adopt A Pass Through of the Fee

Option 1: Allow a 50% pass-through of the Fee (\$8.63/month or \$9 if the Board elects to round the Fee to the nearest dollar) that applies only to tenancies that started on or before July 21, 2015 (where no vacancy rent increase has been taken since the implementation of rent control). The Board can institute a waiver of the pass-through for low-income Tenants. Under such a policy, once the landlord has had at least one vacancy rent increase post-July 21, 2015, the pass-through would no longer apply to that unit going forward (as it is likely that most vacancies would result in rent increases far exceeding the \$17.25 monthly cost of the Fee).

Concerns Regarding a Waiver of the Pass-Through for Low-income Tenants: The Board is advised to avoid any pass-through policy that requires income verification for low-income Tenants. Income verification is intrusive to Tenants and takes significant staff time, which would likely cost the program more than it would save Landlords and could result in driving up Fees still further. Additionally, exempting low-income Tenants from paying a portion of the Rental Housing Fee may create a disincentive to renting to low-income Tenants, which is contrary to Fair Housing Law.

Option 2: Allow a pass-through of approximately \$4 per month or 25% of the Fee. The Board could decide whether or not the pass-through would only be applicable to tenancies that started on or before July 21, 2015 or to tenancies that have started post July 21, 2015.

Under this proposal, 25% of the Fee would be passed on to the all rent controlled Tenants regardless of their income status. This would amount to approximately \$4.31/month. To keep the calculation simple, the Board would be advised to round down to \$4.00 per month. Because there would be no need to verify income, administering the pass-through would be less complicated to keep staff costs down.

The table on the following page contains a comparison of pass-through policies in comparable jurisdictions with actively-enforced rent programs.

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**Table of Pass-Through of Registration Fees For Rent Control Programs Similar to Richmond's**

Jurisdiction	Program Budget (FY 17-18)	APPLICABLE RENTAL UNITS	FY 2017-18 Fees (per unit)	monthly pass-through amount	Portion of fee passed through to tenants
<b>ACTIVELY ENFORCED RENT PROGRAMS</b>					
Berkeley	\$5,125,740	19,093	\$270.00	\$11.00/month	50% only to pre-1996 Tenants; City may reimburse low-income tenants
Santa Monica	\$5,181,693	27,542	\$198.00	\$8.25/month	50% Waiver for low-income Tenants
East Palo Alto	\$427,415	2,325	\$222.00	\$9.75/month	50%
PROPOSED Richmond OPTION 1	\$2,804,925	9,558 fully covered units; 10,460 partially covered units	\$207.00 for fully covered units; \$100 for partially covered units; \$50 for governmentally-subsidized units	OPPTION 1: \$8.63/month  (\$9/month if Board decides to round up)	50% Waiver for low-income tenants
Proposed Richmond option 2	\$2,804,925	9,558 fully covered units; 10,460 partially covered units	\$207.00 for fully covered units; \$100 for partially covered units; \$50 for governmentally-subsidized units	OPPTION 2: \$4.31/month  (\$4/month if the Board decides to round down)	25% Would apply to all rent controlled tenants regardless of income