

# AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: August 15, 2018

Final Decision Date Deadline: August 15, 2018

**STATEMENT OF THE ISSUE:** According to the Association of Bay Area Governments (ABAG), in a major earthquake on the Hayward or San Andreas faults, it is estimated that five percent of the Bay Area's housing stock—approximately 150,000 units—will be immediately and permanently damaged, causing approximately \$85-90 billion in direct residential building-related economic losses. This loss of housing could have dramatic negative effects on Tenants and Landlords in the City of Richmond. The Rent Board has an opportunity to potentially mitigate such negative effects by establishing policy and programs to encourage seismic safety improvements in residential structures.

## 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

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

**RECOMMENDED ACTION:** RECEIVE a memorandum from Dr. Kenneth Baar concerning a Capital Improvement Regulation and DIRECT staff to collaborate with the Planning and Building Services Department to monitor the frequency with which property owners are investing in seismic safety improvements and devise Rent Board policy and/or program options for encouraging such improvements and educating community members about how to prepare for earthquakes – Rent Program (Nicolas Traylor 620-6564).

AGENDA ITEM NO:

**H-1.**



# AGENDA REPORT

**DATE:** August 15, 2018  
**TO:** Chair Gray and Members of the Rent Board  
**FROM:** Nicolas Traylor, Executive Director  
**SUBJECT:** SEISMIC SAFETY AND THE RENT ORDINANCE

## **STATEMENT OF THE ISSUE:**

According to the Association of Bay Area Governments (ABAG), in a major earthquake on the Hayward or San Andreas faults, it is estimated that five percent of the Bay Area's housing stock—approximately 150,000 units—will be immediately and permanently damaged, causing approximately \$85-90 billion in direct residential building-related economic losses.<sup>1</sup> This loss of housing could have dramatic negative effects on Tenants and Landlords in the City of Richmond. The Rent Board has an opportunity to potentially mitigate such negative effects by establishing policy and programs to encourage seismic safety improvements in residential structures.

## **RECOMMENDED ACTION:**

RECEIVE a memorandum from Dr. Kenneth Baar concerning a Capital Improvement Regulation and DIRECT staff to collaborate with the Planning and Building Services Department to monitor the frequency with which property owners are investing in seismic safety improvements and devise Rent Board policy and/or program options for encouraging such improvements and educating community members about how to prepare for earthquakes – Rent Program (Nicolas Traylor 620-6564).

## **FISCAL IMPACT:**

There is no fiscal impact related to this item at this time. Staff members anticipate utilizing staff resources budgeted for Fiscal Year 2018-19 for the completion of this study.

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<sup>1</sup>Association of Bay Area Governments Resilience Program. "Housing." 2018. Accessed 08/08/18. <http://resilience.abag.ca.gov/housing/>

**DISCUSSION:**

Probability of Hayward Fault Earthquake and Anticipated Damage to Residential Structures

According to the Association of Bay Area Governments (ABAG), the Hayward fault has the greatest likelihood of rupturing in the next 30 years compared to all other faults in the Bay Area, with a 31 percent chance of an earthquake magnitude of 6.7 or higher.<sup>2</sup> Should the Hayward fault rupture, an estimated 7,200 residential buildings in Contra Costa County would be uninhabitable (Attachment 1). This figure represents approximately two percent of total residential buildings in the County. Building losses will differentiate depending on the type of structure, with multifamily and manufactured homes sustaining more significant damage compared to single family homes.<sup>3</sup>

The potential for residential destruction due to an earthquake in the City of Richmond may be particularly pronounced given the City's relatively old housing stock. The City's 2015-2023 Housing Element reports that after 30 years, most housing units show signs of deterioration and need reinvestment to maintain its condition. Without proper maintenance, housing that is over 50 years old requires major reinvestment to maintain its quality and appearance. Homeowners with older units may require assistance to upgrade conditions or such units will become substandard for use by homeowners or renters and many eventually become unsuitable for occupancy. It is estimated that as of 2013, 70.4 percent of Richmond's housing units were over 30 years old and that 47.6 percent were over 50 years old, which indicates an older housing stock.

Nexus with the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance and Services Provided by the Richmond Rent Program

The stated purpose of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance is to promote neighborhood and community stability, healthy housing, and affordability for renters in the City of Richmond by controlling excessive rent increases and arbitrary evictions to the greatest extent allowable under California law, while ensuring Landlords a fair and reasonable return on their investment and protecting homeowners (Section 11.100.010, Richmond Municipal Code.)

The high probability of a major earthquake in the Bay Area within the next 30 years and the projected damage associated with such an event poses a significant threat to homeowners and affordability for renters in the City of Richmond. Therefore, the Rent Board may find it prudent to examine the frequency with which property owners are investing in seismic improvements and devise Rent Board policy and/or program options for both encouraging such improvements and educating community members about how to prepare for earthquakes. Staff members anticipate collaboration with the

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<sup>2</sup> Association of Bay Area Governments Resilience Program. "Contra Costa County Earthquake Program." 2018. Accessed 08/08/18. <http://resilience.abag.ca.gov/earthquakes/contracosta/>

<sup>3</sup> Association of Bay Area Governments Resilience Program. "Expected Housing Losses in an Earthquake." 2018. Accessed 08/08/18. <http://resilience.abag.ca.gov/housing/losses/>

Planning and Building Services Department would be necessary to ensure effective implementation of any such policy or program.

Community education is a core component of the services provided by the Richmond Rent Program and presents one opportunity for the City to disseminate information about preparing for an earthquake to renters and homeowners. Indeed, in their list of identified actions cities can take to mitigate the negative effects of an earthquake, ABAG identifies the importance of community education in addition to creating an inventory of vulnerable buildings and making a plan for retrofitting homes that are likely to be damaged. The language of this recommendation is reproduced below, and contained within Attachment 2, page 7, of this report.

***Educate homeowners, building owners, and tenants about their risks.***

*Everyone in the region – renter, homeowner, high income, or low income – can benefit from enhanced knowledge about risks to make smarter decisions to prepare for earthquakes. While there are many factors that influence how people choose to respond to risk, including what their neighbors are doing, knowledge of risks, and what can be done to help mitigate those risks, is fundamental. Making information easily accessible is important, such as through a city website, and conducting varied outreach to all communities can help with information sharing. Cities and counties can educate residents on options such as structural retrofit, bracing hot water heaters, mitigating brick chimneys, securing furniture, cupboards, and other interior falling hazards, preparing to shelter in place by making an earthquake kit with food, water, and other necessary supplies, and purchasing earthquake insurance (for both homeowners and renters).*

### Existing Policy Framework

#### **2015-2023 Housing Element**

State law requires every jurisdiction in California to adopt a comprehensive, long-term General Plan to guide its physical development; the Housing Element is one of the seven mandated elements of the General Plan. Housing Element law mandates that local governments adequately plan to meet the existing and projected housing needs of all economic segments of the community.

On May 19, 2015, the Richmond City Council adopted the 2015-2023 Housing Element. The Housing Element identifies the following actions with respect to seismic safety:

<b>2015-2013 HOUSING ELEMENT</b>		
<b>Action</b>	<b>Description</b>	<b>Status</b>
Program H-2.5.6: Soft-Story Building Inventory	Continue to maintain the City’s inventory of multi-story buildings with potential earthquake hazards and consider making it readily available to property owners and residents to raise awareness and encourage voluntary health and safety retrofits.	<p>Planning Staff completed a preliminary Soft Story Inventory for multi-family properties in the City. The Planning and Building Division held a community workshop on Earthquake Hazard Reduction and Soft Story Buildings on August 31, 2011. The workshop included presentations by representatives from Association of Bay Area Governments (ABAG), Enginious Engineering and participation by local structural engineers and the California Apartment Association. The workshop provided information on the potential risks and hazards of Soft Story Buildings, provided information about financial and professional resources for interested property owners and discussed best practices and existing Soft Story Ordinances in neighboring cities. The Building Division has a webpage dedicated to providing additional information and resources for interested property owners. The Planning and Building Division will continue to gather information and engage the public regarding Earthquake Hazard Reduction and Soft Story Buildings.</p> <p>UPDATE: Planning staff completed a preliminary Soft Story Inventory for multi-family properties in the City and identified at least 280 potential soft story structures.</p>
Program H-2.5.7: Soft-Story Building Ordinance	Study soft-story building ordinances in California to learn about effective practices being used to incentivize the seismic retrofitting of hazardous multi-story buildings. Consider adopting a soft-story ordinance based on the study’s findings and input from the community and landlords.	<p>The City developed a webpage regarding earthquake safety and hazards  <a href="http://www.ci.richmond.ca.us/index.aspx?nid=2378">http://www.ci.richmond.ca.us/index.aspx?nid=2378</a>.</p> <p>The City has initiated the Zoning Ordinance Update and will consider a soft-story building ordinance as part of that effort.</p> <p>UPDATE: On November 15, 2016, the Zoning and Subdivision of the Richmond Municipal Code (Ordinance 16-16) was adopted by the City Council. A Soft Story Building Ordinance is not included.</p>

## **Standard Plan Set A**

The Planning and Building Services Department developed Standard Plan Set A to provide a low-cost method to help improve an older home's chances of withstanding an earthquake. When approved by the local building official, the plan set may be used to strengthen older single family homes and duplexes without the need for an engineer to develop costly site-specific plans and design calculations.

Standard Plan Set A applies only to one or two family residential structures consisting of two stories or less, with wood frame construction, a continuous perimeter foundation, cripple walls of less than four feet in height, less than four vertical feet of brick or stone veneer along the exterior walls, and roofing consisting of material other than clay tile. Standard Plan Set A includes bolting the cripple wall mudsill to the foundation, installing plywood brace panels to the cripple walls, and connecting the cripple wall to the floor above.

More information on Standard Plan Set A is accessible at <http://www.ci.richmond.ca.us/2378/Earthquake-Hazard-Reduction>.

## **Rent Board Regulations**

Capital improvement policies within the context of rent control laws in California cities are varied in scope and approach. A memorandum to the Board from Dr. Kenneth Baar discusses the landscape of such policies and related considerations (Attachment 2).

With respect to capital improvement policies to incentivize certain types of investments, Dr. Baar reports:

*New municipal requirements for seismic upgrading have become widespread in recent decades, requiring apartment owners to meet standards that were not in effect when the building was constructed or purchased by the current owner. Commonly, capital improvement standards allow for more favorable allowances of rent increases to cover the costs of seismic upgrades and improvements that increase energy efficiency and/or are for seismic work. Most commonly, the regulations applicable to incentivized improvements allow for 100% cost recovery, as opposed to lower percentages for capital replacements. Alternatively, incentivized improvements do not have to be justified with a fair return analysis in jurisdictions that require such consideration for capital replacements. San Jose limits rent increases for incentivized improvements to 3%.*

Existing Rent Board Regulations allow for Individual Adjustments of the Maximum Allowable Rent for seismic retrofitting. Section 11.100.070(e) of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance provides, "in making individual adjustments of the Annual Adjustable Rent Increase, the Board shall consider

the purposes of this Chapter and the requirements of law.” Section 11.100.070(g)(8) further clarifies, “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.” Therefore, any proposed capital improvement policy adopted, whether tied directly to MNOI or through an alternative stand-alone Fair Return analysis, must consider Fair Return in any adjustment of the Maximum Allowable Rent.

In March 2018, the Rent Board adopted standards for individual adjustments of the Maximum Allowable Rent utilizing a Maintenance of Net Operating (MNOI) fair return standard, which considers the costs of capital improvements, including structural and foundational retrofitting, in its determination of individual rent adjustments.

Regulation 905, adopted by the Board on March 21, 2018, permits the costs of retrofitting to be included in the calculation of Net Operating Income (Attachment 3). Such costs are amortized over a period of ten to 20 years, depending on the specific improvement.

### Next Steps

Should the Rent Board direct staff to collaborate with the Planning and Building Services Department to monitor the frequency with which property owners are investing in seismic safety improvements and devise Rent Board policy and/or program options for encouraging such improvements and educating community members about how to prepare for earthquakes, staff members propose the following next steps, to be undertaken over the course of the next 12 months:

- Develop a strategy with the Planning and Building Services Department to monitor and document the frequency with which property owners are investing in seismic safety improvements
- Conduct case study research to understand the landscape of policies and programs in other cities in the Bay Area, such as Berkeley and Oakland, with respect to seismic safety and improvements, and the extent of Rent Board and Rent Program involvement in the implementation of such policies and programs
- Identify and evaluate the feasibility of potential policies and programs to incentivize investment and educate community members about seismic safety
- Consider including a workshop pertaining to seismic safety in the 2019 Richmond Rent Program Community Workshop Calendar

**DOCUMENTS ATTACHED:**

Attachment 1 - Bay Area Earthquake Residential Building Damage & Displacement  
White Paper

Attachment 2 – Memorandum from Dr. Kenneth Baar Concerning a Capital  
Improvement Regulation

Attachment 3 – Rent Board Regulations Chapter 9

# Bay Area Earthquake Residential Building Damage & Displacement White Paper

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January, 2018

An earthquake on any of the 16 major faults in the Bay Area has the potential to significantly damage residential housing, displacing residents and causing significant financial impacts to homeowners, building owners, and tenants. ABAG has identified housing as a major cornerstone of the region's resilience – retaining existing housing is crucial to expediting and ensuring an effective disaster recovery. Limiting catastrophic housing damage keeps residents in their homes and not only helps people who may lack the resources to effectively recover from a disaster, but keeps communities intact.<sup>1</sup>

Though many people are familiar with the San Andreas and Hayward faults, and indeed these are the faults capable of producing the largest earthquakes in the Bay Area, earthquake hazards vary throughout the region due to the existence of numerous smaller faults. While impacts from an earthquake on these faults will not be as widespread, they could still produce significant localized impacts. A fault map and a deaggregation map, showing which fault is likely to be the largest contributor to shaking hazard at any given point in the Bay Area, are included in Appendix A.

## What will be the impacts of a major earthquake on the region's housing?

The impacts of an earthquake on the residential housing stock, and therefore residents, can be measured in a few ways. In this study, we estimated the number of uninhabitable buildings, the building damage dollar amount (calculated using 2014 building values), and number of displaced households (determined similar to uninhabitable buildings, but using assumptions about occupancy rate to convert units to households). The number of uninhabitable buildings was calculated using the assumption that 100% of single family or multifamily homes with complete damage will be uninhabitable; 65% of multifamily homes and 40% of

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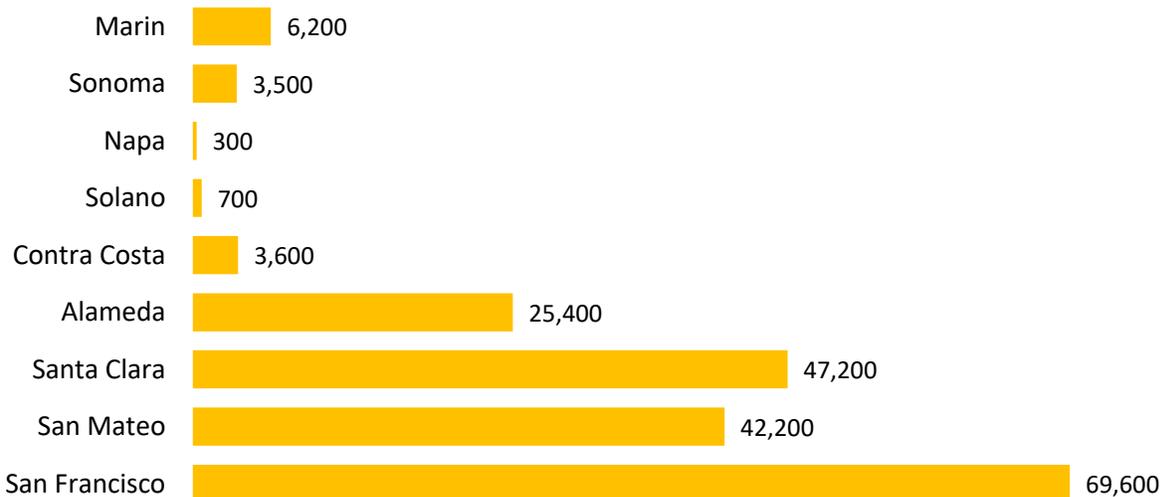
<sup>1</sup> More analysis of the region's fragile housing types, as well as where these fragile housing types house vulnerable community members, can be found in ABAG's 2015 report *Stronger Housing, Safer Communities: Strategies for Seismic and Flood Risks*. [http://resilience.abag.ca.gov/projects/stronger\\_housing\\_safer\\_communities\\_2015/](http://resilience.abag.ca.gov/projects/stronger_housing_safer_communities_2015/)

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single family homes with extensive damage will be uninhabitable; and 40% of multifamily homes and 20% of single family homes with moderate damage will be uninhabitable.

## *San Andreas Scenario*

In the earthquake scenario with the greatest impact to the region, a magnitude 7.8 on the San Andreas Fault (similar to the 1906 earthquake), approximately 198,700 households will be displaced from 68,900 uninhabitable buildings, with \$28.4 billion in direct residential damages. Approximately 35% of the displaced households (69,600) will be in San Francisco; San Mateo and Santa Clara Counties will also have large numbers of displaced households (42,200 and 47,200 respectively). In San Francisco, this number represents just over 20% of total households; in San Mateo County this is approximately 16% of households, but in more populated Santa Clara County these 47,200 households represent 7.8% of all households. Effects are much less severe for counties farther from the fault: in Solano, Contra Costa, and Napa Counties 1% or fewer households are anticipated to be displaced (0.5%, 1%, and 0.6%, respectively).



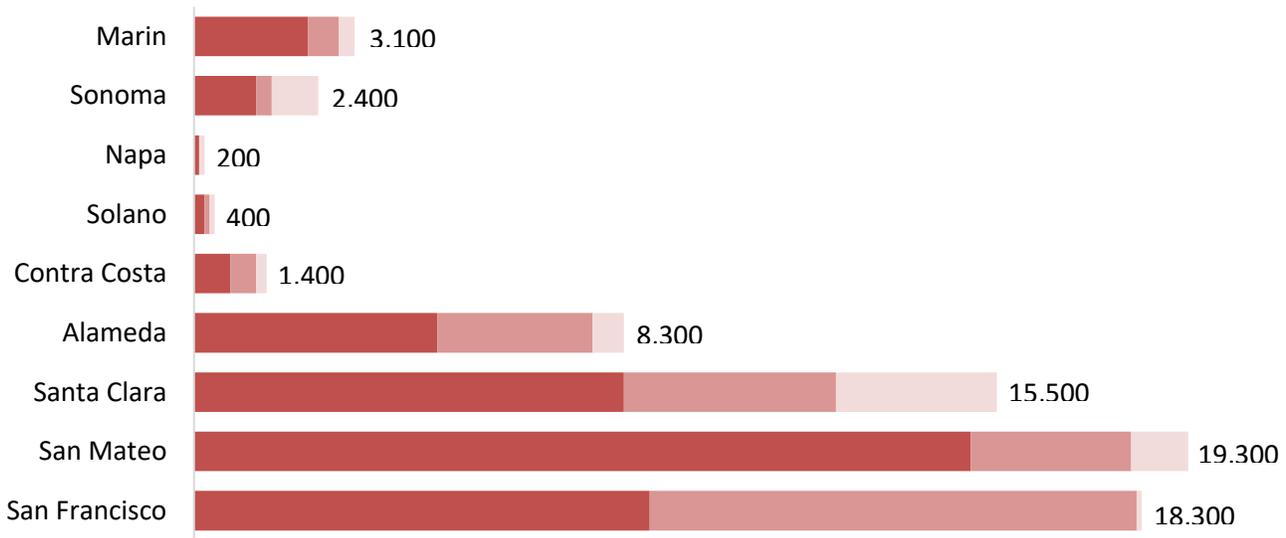
*Figure 1: Displaced households (all residential types) from a M7.8 earthquake scenario on all Northern segments of the San Andreas Fault*

While the absolute number of *households displaced* is highest in San Francisco, San Mateo County will have the largest number of uninhabitable residential *buildings* (19,300, approximately 10% of total residential buildings in San Mateo), followed by San Francisco (18,300, approximately 11% of total residential buildings in San Francisco) and Santa Clara (15,500, approximately 3.5% of total residential buildings in Santa Clara). On average, San Francisco has a higher number of households per building due to more multifamily buildings (an average ratio of 3.8 displaced households for every uninhabitable building) while San Mateo County has a lower number of households per building due to more single family buildings (an average ratio of 2.2 displaced households for every uninhabitable dwelling), so even though fewer total residential

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*buildings* are damaged in San Francisco, more households per building means more displaced households.<sup>2</sup> Napa County, on the other hand, will have only 200 uninhabitable residential buildings (0.4% of total number of residential buildings in Napa), Solano County 400 (0.3% of total number of residential buildings in Solano County), and Contra Costa County 1,400 (0.4% of total number of residential buildings in Contra Costa County).

Additionally, while the total residential uninhabitable building count in San Francisco is slightly lower than San Mateo County, the total dollar amount in residential building damage is slightly higher, at \$8.0 billion versus \$7.9 billion in San Mateo County. Santa Clara County will sustain \$6.3 billion in residential building damages, and Alameda County \$3.2 billion. Napa is expected to sustain \$60 million.



	Marin	Sonoma	Napa	Solano	Contra Costa	Alamed <sup>a</sup>	Santa Clara	San Mateo	San Francisc <sup>c</sup>	Total
Uninhabitable buildings – Single Family	2,200	1,200	100	200	700	4,700	8,300	15,000	8,800	36,800
Uninhabitable buildings – Multi-Family	600	300	0	100	500	3,000	4,100	3,100	9,400	19,600
Uninhabitable buildings – Manufactured Homes	300	900	100	100	200	600	3,100	1,100	100	4,900
<b>Total</b>	<b>3,100</b>	<b>2,400</b>	<b>200</b>	<b>400</b>	<b>1,400</b>	<b>8,300</b>	<b>15,500</b>	<b>19,300</b>	<b>18,300</b>	<b>61,400</b>

<sup>2</sup> In San Francisco, the percent of residential buildings that are single household is 76%, vs 24% for multifamily households. In San Mateo, these percentages are 95% and 5%.

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Figure 2: Uninhabitable buildings by residential building type from a M7.8 earthquake scenario on all Northern segments of the San Andreas Fault

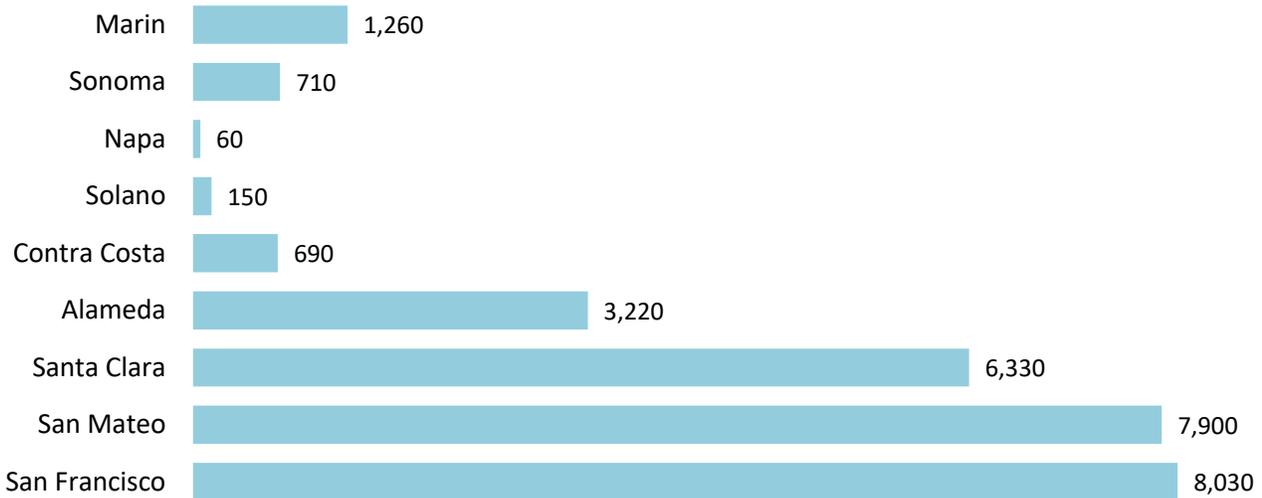
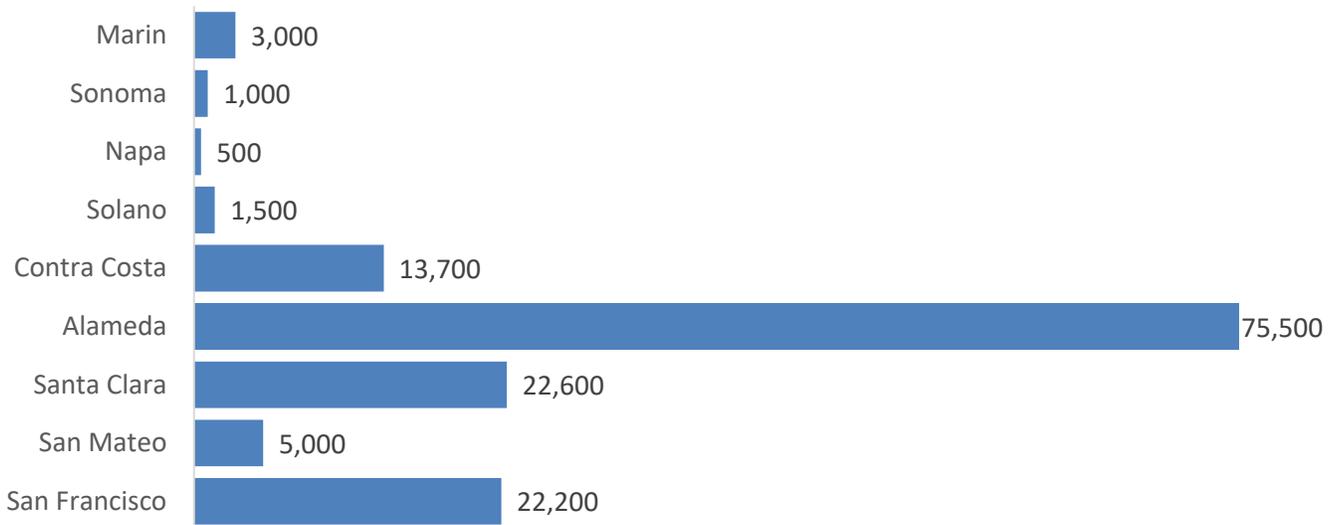


Figure 3: Building damage value (in \$millions) for all residential building types from a M7.8 earthquake scenario on all Northern segments of the San Andreas Fault

## Hayward Scenario

In an East Bay fault earthquake, a magnitude 7.0 on the North and South segments of the Hayward Fault, the overall region-wide numbers will be slightly lower than those for the M7.8 San Andreas event, but distributed differently across the region. In total, approximately 145,000 households will be displaced from 55,100 uninhabitable residential buildings, with \$20.9 billion in damages to those residential buildings. Alameda will have the most displaced households, 75,500 (52% of total displaced households in the region, representing approximately 14% of total households in Alameda County). Santa Clara and San Francisco Counties will each have approximately 15% of the region's total displaced households each (22,600 households, 3.8% of the county's total households, and 22,200 households, 6.4% of the county's total households, respectively). Napa County will have approximately 500 displaced households, or about 1% of the county's total households, and Sonoma County will have approximately 0.5% of the county's total households displaced, or about 1,000 households.



*Figure 4: Displaced households (all residential types) from a M7.0 earthquake scenario on North and South segments of the Hayward Fault*

Alameda County will also have the largest number of uninhabitable residential buildings (32,200, approximately 8% of total residential buildings in Alameda County). All other counties will have fewer than 8,000 uninhabitable residential buildings each, many counties under 1,000 (Solano, Sonoma, and Napa Counties at 800, 600, and 300 uninhabitable residential buildings, respectively). Contra Costa County will have 7,200 uninhabitable residential buildings (just over 2% of total residential buildings in the county), Santa Clara 7,100 (1.6% of total residential buildings in the county), and San Francisco 3,700 (just over 2% of total residential buildings in the county). Again, San Francisco will have a disproportionately large number of displaced households relative to number of buildings because of its prevalence of multifamily buildings<sup>3</sup> (an average of 6 displaced households for every uninhabitable building in San Francisco as compared to an average of 2.3 displaced households per uninhabitable building in Alameda County or an average of 1.7 displaced households per uninhabitable building in Napa and Sonoma Counties).

Total residential building damage is most costly in Alameda County, reaching \$11.2 billion. This is almost four times more than in the second most costly counties, Contra Costa and Santa Clara Counties (\$2.7 billion and \$2.9 billion, respectively). Solano, Sonoma, and Napa Counties are expected to sustain just \$310 million, \$220 million, and \$100 million in residential building damages, respectively.

#### *Other Scenarios*

Other earthquake scenarios show a wide range of damage across the region. A smaller San Andreas Fault earthquake, a magnitude 7.2 on just the peninsula segment of the fault, could produce approximately 120,000 displaced households and 40,000 uninhabitable buildings region-wide, with a smaller Hayward fault earthquake producing similar results. On the other end of the spectrum, a magnitude 7.4 earthquake on

<sup>3</sup> In Alameda County, the ratio of single household residential buildings to multifamily household residential buildings is 92%:8%, vs. 76%:24% in San Francisco.

the Maacama fault (located in Northern Sonoma County) would displace approximately 9,000 households and render 3,800 residential buildings uninhabitable. A summary of all modeled earthquake scenarios is shown below in Figure 5.

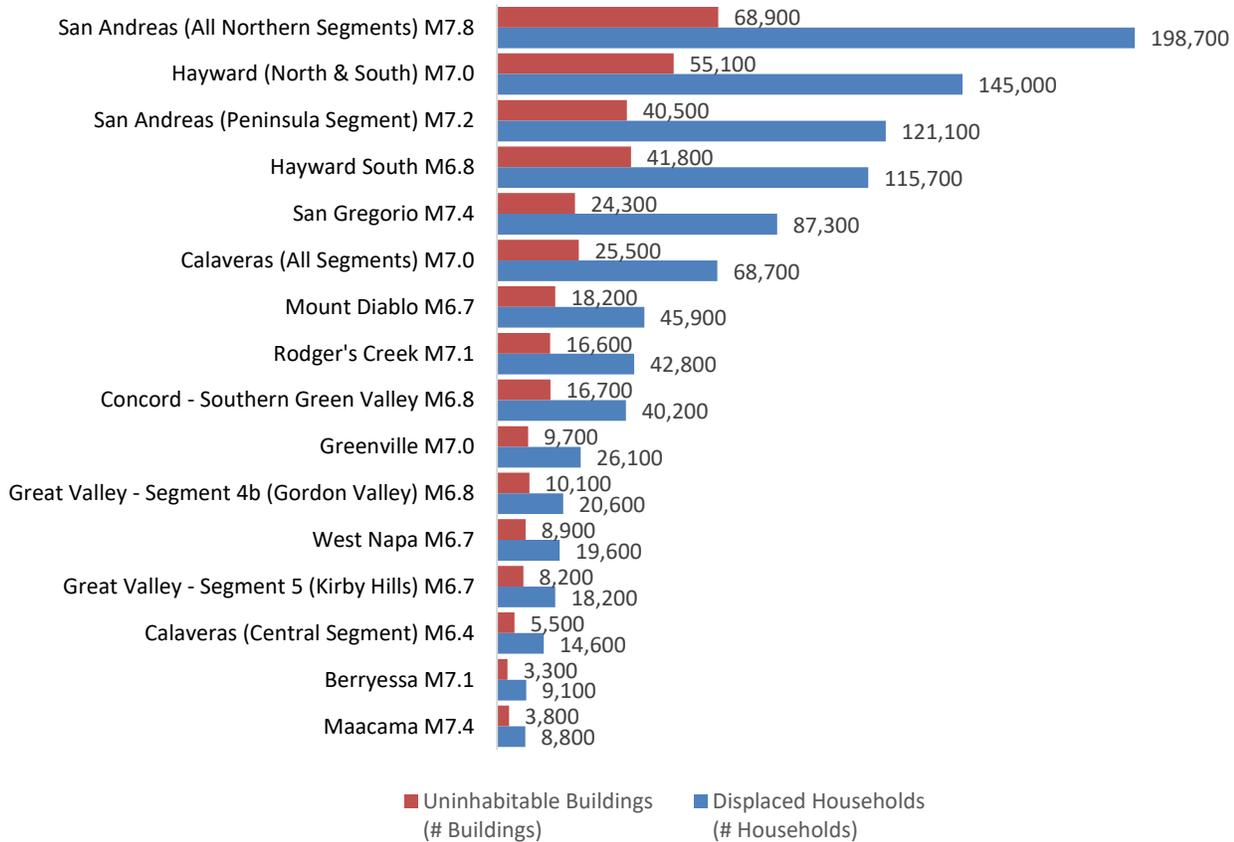


Figure 5: Uninhabitable Buildings and Displaced Households region-wide for 16 Bay Area earthquake scenarios

## What can cities do?

- Create an inventory of vulnerable residential buildings, their exposure to hazards, and their demographic characteristics.** While some earthquakes, such as a large magnitude earthquake on the San Andreas or Hayward faults will likely cause widespread, significant damage, many earthquakes will produce variable damage throughout the region or even within a city. Every county has a different combination of multifamily, single family, and mobile homes that will contribute to the overall residential building damage picture. Loss of each of these home types has different impacts on the community. Additionally, residents within buildings may have highly varied needs, particularly if they house young children, the elderly, residents with medical or functional needs, non-English speakers, or households who depend on social services for food or housing. Multifamily buildings house more residents, so damage to multifamily buildings will result in more displacement; multifamily homes may also sustain greater damage than single family homes. Mobile homes typically sustain the most damage, and typically house lower-income residents, so

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while they may be a small percentage of the total housing stock in a county, they may contribute a significant proportion of displaced households (in Napa County, where mobile homes represent 8% of residential buildings, in a San Andreas M 7.8 event 30% of displaced residents will be from mobile homes). Other factors, like soil type, liquefaction or landsliding, age, construction type, number of stories, and number of units can also influence how homes will perform in an earthquake. Some neighborhoods may be devastated while others remain largely intact. While it is impossible to know exactly where and how damage will play out, jurisdictions should be prepared to assume that some areas will require more resources for response and recovery while others may require less. Jurisdictions should develop inventories of potentially fragile homes, and overlay this information with hazards maps and demographic information, to better understand how an earthquake will impact residents.

- **Make a plan for retrofitting homes that are likely to be damaged.** Once a jurisdiction has a sense of what homes are most fragile in the community, passing policies to encourage or require retrofit helps ensure that the residents who live in the homes will be more protected from death, injury, or displacement during an earthquake. It is important to note that many older buildings will not be able to be retrofitted to a shelter-in-place standard, meaning that damage is minimized to the degree that the homes will be habitable after an earthquake, but can still be retrofitted to protect lives. Any reduction in damage improves the lives of residents, reduces recovery time, protects assets, and helps keep communities more intact.
- **Educate homeowners, building owners, and tenants about their risks.** Everyone in the region – renter, homeowner, high income, or low income – can benefit from enhanced knowledge about risks to make smarter decisions to prepare for earthquakes. While there are many factors that influence how people choose to respond to risk, including what their neighbors are doing, knowledge of risks, and what can be done to help mitigate those risks, is fundamental. Making information easily accessible is important, such as through a city website, and conducting varied outreach to all communities can help with information sharing. Cities and counties can educate residents on options such as structural retrofit, bracing hot water heaters, mitigating brick chimneys, securing furniture, cupboards, and other interior falling hazards, preparing to shelter in place by making an earthquake kit with food, water, and other necessary supplies, and purchasing earthquake insurance (for both homeowners and renters).
- **Plan for sheltering residents.** In any earthquake scenario, cities and counties will likely need to shelter residents whose homes are significantly damaged. Cities and counties need to have an accurate estimate of the magnitude of likely shelter needs in probable earthquake scenarios and develop a plan for serving these populations after an earthquake. A separate White Paper, entitled Bay Area Earthquake Shelter Needs White Paper, outlines in more detail estimated short-term shelter needs as well as considerations for jurisdictions in planning shelters. However, the paper focuses primarily on short-term sheltering. In a larger earthquake, residents may need shelter for several months or even years as their homes are repaired or rebuilt, so cities will need to plan for not just short-term shelters, but interim housing for these residents as well.
- **Encourage protection of investments through insurance.** In some cases, retrofit is infeasible or too costly to justify the level of protection it would provide, such as in very high liquefaction areas or

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in instances where a building sits on top of a fault rupture zone. Additionally, renters have little to no control over whether their buildings are retrofitted. In cases where retrofit is either infeasible or out of an individual's control, earthquake insurance may be the best option for protecting a resident's financial well-being after an earthquake. Earthquake insurance is a separate policy than a traditional homeowner's policy and can be costly, with high deductibles, but in cases of extreme damage, may help homeowners avoid catastrophic financial loss. Insurance can help homeowners repair or rebuild. For renters, earthquake insurance is typically very affordable and can not only protect against loss of building contents but can assist policyholders in paying for alternate housing if their building is damaged to a degree that they cannot live in it. Insurance is especially important for individuals and families that may not have a large financial cushion through savings or family, such as lower income households or young adults. Currently, very few households have earthquake insurance – only 10% of homeowners and 5% of renters have an earthquake policy.

- **Build resilience into your community through building codes for new construction.** While the numbers presented in this paper discuss only existing housing, which, when older, tends to be more fragile and prone to damage than new construction, new construction offers a significant opportunity to build resilience into the next generation of a city. Currently in California, building codes ensure life safety during a major earthquake but are not designed to shelter-in-place standards. This means that while residents will not lose their lives through catastrophic collapse, buildings may very well be damaged to the degree that they will be uninhabitable, leading to displacement, shelter seeking, and costly repairs. Most residents and elected officials are not aware of this and assume that current code ensures adequate performance in an earthquake; while new buildings will most likely perform better than older buildings, “adequate” performance in the eyes of the public may be different than in the eyes of the code developers. Amending the building code with a local amendment that raises new construction standards can help prevent these consequences and build a more resilient future into the next generation of a city.
- **Plan for Whole Community Recovery.** Housing is critical to disaster recovery – when people are able to stay in their homes after a disaster, social networks remain intact, vulnerable populations are less likely to be pushed out, employees are able to return to work faster and keep the economy stronger, and recovery overall moves quicker. Less damage to housing also means fewer repairs and less loss of personal wealth. However, housing is not the only factor that dictates whether residents stay or leave the community. There are a number of other interconnected factors that either ensure that residents can stay or forces them to leave, independent of the state of their housing. One of the most critical, particularly after the first few days, is utility services. While residents may be able to survive for several days or weeks without electricity, access to water and wastewater services are far more critical to public health. After these basic needs, once recovery begins, residents will also need to meet other everyday needs such as access to grocery stores, pharmacies, day care, and doctor's offices as well as be able to access their jobs to maintain their income. Critical to accessing these resources is a functioning transportation system, including bridges and roads as well as public transit. Longer term, societal trends will impact whether people stay or go. If the economy is unable to recover, people may leave to access better jobs elsewhere. If major demographic shifts occur due to displacement, people may choose to leave if they no longer

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feel welcome in their community. Lastly, if residents no longer feel a sense of community because their social group, church community, or neighbors are no longer intact, they may choose to leave the region even if all other aspects are in place.

- **Talk to your neighboring jurisdictions and plan outside your jurisdictional boundaries.** Many neighboring jurisdictions will also be significantly damaged, so displaced people may have to go far to find short and long-term housing. The effects of a major earthquake will impact the whole region, so cooperation between neighboring cities will be critical. You will not likely be able to depend on your neighboring jurisdictions to house displaced residents, leading many displaced residents out of the region entirely. This exodus can be managed by ensuring that adequate shelters are planned for as well as strengthening existing housing. Housing retrofit is most beneficial when it occurs where fragile housing exists, not just within specific jurisdictional boundaries. Nearby cities with similar housing stock should work together to develop similar policies and ensure that buildings are retrofitted along similar timelines to avoid uneven devastation, displacing residents across city boundaries.



MEMORANDUM

**TO:** Chair Gray and Members of the Rent Board  
**FROM:** Dr. Kenneth Baar, Consultant  
**DATE:** August 15, 2018  
**SUBJECT:** Rent Adjustments Based on Capital Improvements

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*I. Introduction*

This memorandum discusses the various alternatives that have been adopted by other jurisdictions in regard to allowances for capital replacements and issues related to the selection of a policy. Rent control programs have adopted varying approaches in regard to allowable rent increases for capital improvements.

The principle distinction among these policies has been whether or not they allow rent increases for capital “replacements” without consideration of overall income (rent increase history) and expenses or only allow additional rent increases for capital “replacements” when an owner can demonstrate they are necessary to provide a fair return. Replacements include costs such as roof replacements and replacements of aging structural systems that are inevitable in the course of property ownership.

Richmond’s current fair return –regulation – a maintenance of net operating income (MNOI) standard – provides for the inclusion of capital improvement expenditures as amortized operating costs in considering whether the property yields a fair return. This memo addresses issues related to whether rent increases should also be authorized for the amortized cost of capital improvements (including capital replacements) without consideration of whether the rent increases are needed in order to obtain a fair return. Under the MNOI standard, the cost of a capital replacement is considered in conjunction with consideration of how much rents and overall operating costs have increased since a base year, while “stand alone” rent increase allowances for capital replacements would only consider the cost of the capital improvement.

Among the jurisdictions that allow for increases to cover the costs of capital replacements without consideration of fair return , varying policies have been adopted in regard to: 1) caps on rent increases based on capital improvements; 2) limits on the percentage of capital improvement costs that can be passed through; 3) interest allowances for capital improvement costs, 4) amortization periods for capital improvements, 5) whether capital improvement

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increases expire when amortized or become permanent; 6) whether capital improvement increases are added to the base rent.

Separate from consideration of the costs for capital replacements, separate increase allowances are commonly authorized for specially incentivized improvements, such as seismic upgrades or improvements to increase energy efficiency, without consideration of whether they are necessary to permit a fair return. This memo does not address the policies and issues related to such standards.

### *II. The Context for Consideration of Allowable Rent Adjustments Based on Capital Improvements*

Issues related to capital improvement increases should be placed within the perspective of the overall rent regulation scheme.

#### A. Capital Improvement Rent Increases Superseded by Vacancy Decontrol

A rationale for capital improvement increases is that they should be permitted because landlord rent increases are constrained by regulation.

Based on this concept, the capital improvement increase regulations of other jurisdictions provide that such increases are not applicable to a tenancy that commences after the performance of capital improvement. This policy is based on the concept that, when there is a vacancy, the landlord has been able to reset the rents at a market level unconstrained by the rent regulation and, therefore, should not be able to claim an additional capital improvement increase.

Usually capital improvement regulations also provide that a claim cannot be made for a capital improvement increase for a unit in which the tenancy commenced a short period before the capital improvement application. Such provisions are also based on the concept that the landlord has just had an opportunity to reset rents at market levels and therefore, should not be permitted additional rent increases for work that would or should have been reasonably anticipated when the tenancy commenced.

To place these restrictions in perspective, it is critical to consider that rates of turnover in tenancies in California are substantial. The Census Bureau's American Housing Survey (AHS) data for Richmond for 2016 projected that 26.2% of all tenancies had commenced within the last 12 months and that 78.2% of all tenancies had commenced in 2010 or later. The data is subject to the limitation that it is based on a small sample. The consequence of the substantial rate of turnover of tenancies is that a substantial portion of rent adjustments for capital improvements would have a short duration since they would be considered only for the duration of the current tenancy. Of course, there are buildings with rates of turnover much below the average.

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One scenario may be a three-year tenancy following the completion of the capital improvement, which commenced one year prior to the capital improvement application. Within the three-year period, the owner would recover approximately 30% of the cost of an improvement, with a 20-year amortization period. (For example, if a capital improvement with a 20-year life cost \$5,000/rental unit and a 7% interest allowance was provided, \$1,400 in rent increases would be provided within three years in order to cover the 7% interest and the first three years of the amortization of the expense.)

In another scenario, a two-year tenancy beginning six months prior to a capital improvement application and ending eighteen months after the completion of the capital improvement, most or all of any capital improvement increase for that unit may be precluded on the basis that the owner has been able to rely on market rents for that unit.

### B. Annual General Adjustments

Under the Richmond rent control ordinance apartment owners are permitted annual percentage rent increases equal to the percentage increase in the Consumer Price Index (CPI). The ordinances of Los Angeles, San Jose, and Oakland also provide for annual increases equal to 100% of the percentage increase in the CPI. Other jurisdictions limit annual increases to a portion of the percentage increase in the CPI. Annual increase limits are: San Francisco - 60% of CPI increase, Berkeley - 65%, Santa Monica and West Hollywood - 75%. Since 2000, the CPI has increased by 2.8%/year on average.

### C. Increases in Rents

This author was not able to locate systemic data on the rate of increase in rents within the City of Richmond. Assuming that the rates of increase in rents in Richmond have paralleled the trends in the Bay Area, in recent years, rents have increased at a rate far above the rate of increase in the CPI. Furthermore, since 2010 rents in the Bay Area have increased at a rate far above the national average. The Bay Area CPI rent index increased by 40.2% from 2010 to 2017, compared to an increase in the U.S. CPI rent index of 23.6%.

<b>Table A: Consumer Price Index</b>		
<b>Increases in CPI all items and CPI rent index</b>		
<b>U.S. and S.F. Bay Area compared</b>		
	<b>Pct Increase in CPI-all items 2010-2017</b>	<b>Pct Increase in CPI rent index 2010-2017</b>
<b>U.S.</b>	<b>18.2%</b>	<b>23.6%</b>
<b>SF Bay Area</b>	<b>20.9%</b>	<b>40.2%</b>

Data Source: See CPI tables in Appendix A

*III. Options and Policies in Other Jurisdictions*

A. Allowable Increases for Capital Replacements

**1. Standards for Allowable Capital Replacement Increases that Do Not Take into Account Fair Return**

San Francisco, Los Angeles, and Oakland, permit stand-alone rent increases for capital improvements without consideration of rent increases and operating costs.

Each of these cities places limits on the portion of the cost that can be passed through and on the amount of the increase that may be imposed within a year. These limits are described in subsequent portions of this memo.

**2. Standards for Allowable Capital Replacements Increases that Take into Account Fair Return**

Under approaches that have taken into account fair return in considering capital improvement applications, very few apartment owners have obtained rent increases. This outcome can be attributed to the exceptional rent increases in rents that have occurred due to the vacancy decontrols. They have occurred notwithstanding the limitations of annual allowable rent increases to less than 100% of the annual increases in the CPI.

This type of standard is in effect in Santa Monica and West Hollywood. Recently, San Jose modified its capital improvement increase standards, by limiting stand-alone increases to cases involving new capital improvements, as opposed to capital replacements. Stand-alone increases are limited to new services that increase safety or sustainability of seismic readiness.

Berkeley also uses an approach which differs but provides an outcome substantially similar to using a fair return approach, in the sense that it takes into account rent increases that have occurred, but not operating expenses. Under Berkeley's regulations, increases due to vacancy decontrols which are above the annual general adjustments are an offset against any allowable rent increase for pass-through of capital improvement expenditures. This approach obviates the need to prepare a Maintenance of Net Operating Income fair return application with documentation of operating expenses in order to determine if the previous rent increases were adequate to cover the proposed capital improvement increases.

<b>Table 2: Scope of Review in Considering Allowable Rent Increases for Replacements</b>		
City	Cap Improvement Allowances without consideration of fair return or rent history	Cap Replacement Allowances based on consideration of fair return or rent history
Los Angeles	X	
San Francisco	X	
Oakland	X	
San Jose		x
Berkeley		x
Santa Monica		x
West Hollywood		x

**B. Advance Approval Contingent Upon Completion of Capital Improvements**

Commonly under rent regulations, apartment owners can obtain advance approval of rent increases based on proposed capital improvements, with implementation of the increase contingent on completion of the capital improvement. This approach is strongly recommended based on the concept that owners should be able to obtain a determination of what rent increases will be permitted prior to making an expenditure based on an expectation about what increase would be approved.

**C. Types of Capital Improvements with Special Incentives**

New municipal requirements for seismic upgrading have become widespread in recent decades, requiring apartment owners to meet standards that were not in effect when the building was constructed or purchased by the current owner. Commonly, capital improvement standards allow for more favorable allowances of rent increases to cover the costs of seismic upgrades and improvements that increase energy efficiency and/or are for seismic work. Most commonly, the regulations applicable to incentivized improvements allow for 100% cost recovery, as opposed to lower percentages for capital replacements.

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Alternatively, incentivized improvements do not have to be justified with a fair return analysis in jurisdictions that require such consideration for capital replacements. San Jose limits rent increases for incentivized improvements to 3%.

## D. Factors that Determine the Amounts of the Capital Replacement Increases in Jurisdictions which Authorize Capital Replacement Increases without Consideration of Fair Return

Each of the following factors are common determinants of the amount of rent increases granted for capital replacement improvements in jurisdictions which authorize capital replacement increases without consideration of increases in overall rents and operating expenses. If increases are authorized without consideration of fair return or overall increases in rental income, these factors should be considered and weighed in conjunction with each other as parts of an overall “package” that play a role in outcomes under a regulation.

### 1. Share of Cost that Can be Passed Through

Commonly among the ordinances that permit adjustments for capital improvements without consideration of overall income, only a portion of the expenditure is considered when calculating the allowable increase.

Los Angeles permits a pass-through of 50% of the cost. San Francisco permits a pass-through of 50% of the costs in buildings with six units or more and 100% of the cost in buildings with less than six units. Oakland allows a pass-through of 70% of the cost.

<b>Table 3: Portion of Capital Improvement Cost Included in Rent Adjustment Calculation</b>	
<b>City</b>	<b>Portion of Cost Passed Through</b>
Los Angeles	50%
San Francisco	5 units or less - 100% 6 or more units - 50%
Oakland	70%

### 2. Caps on Allowable Pass-through Amounts

Caps on the allowable rent increase for a stand-alone capital improvement increase are common. The most common cap is a 10% ceiling on the allowable increase within a year, with a provision that additional increases may be imposed in future years. The overall cap may be a

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ceiling on a combination of the annual general adjustment and the capital improvement increase.

**3. Amortization Periods**

Allowable amortization periods vary greatly among the standards. As a practical matter, the length of the amortization period is a central determinant of the increase that will be obtained as a result of the capital improvement, since it determines what portions of the cost will be recovered before vacancies for most units supersede the pass-through.

Los Angeles uses a five-year amortization period. San Francisco uses seven and ten year periods for buildings with more than five units and ten, fifteen, and twenty year periods for buildings with five units or less.

<b>Table 4: Amortization Periods Under Capital Replacement Standards</b>	
<b>City</b>	<b>Incentive Categories</b>
Los Angeles	5 years
San Francisco	5 units or less - 10,15,20 years 6 or more units 7 or 10 years
Oakland	Detailed Cap Imp Schedule 5 to 20 years

**4. Interest Allowance**

Under some of the regulations authorizing stand-alone capital improvement increases, an interest allowance is provided. There are about as many variations of the allowable interest rate as jurisdictions which include an interest allowance. Some jurisdictions allow the use of the actual interest rate incurred for the cost of the capital improvement. Other jurisdictions only permit uniform rates tied to published interest rates.

If an interest allowance is provided, it should be uniform for all owners, rather than tied to their actual financing costs and/or whether or not they used their own funds to finance the improvement. As discussed it in this author’s report on fair return cases, in three cases,

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California appellate cases have concluded that differences in allowable rent increases based on differences in individual owners financing arrangements have no rational basis.<sup>1</sup>

Also, if an interest allowance is provided, this author recommends that it be tied to the same index that is included in the fair return standard. That index, the PMMS (Federal Home Loan Mortgage Corporation, Prime Mortgage Market Survey), reflects costs of obtaining capital for home purchases with an additional two percent to reflect higher interest costs that would be expected for commercial real estate borrowing.

### **5. Whether Capital Improvement Increases Expire when Amortized or Are Permanent**

During the Board's consideration of a fair return standard, there was considerable discussion of whether capital improvement increases should be permanent or should terminate after the amortization period.

In considering this issue, it would be reasonable to take into account other aspects of any capital improvement standard such as whether there is an interest allowance, the length of the amortization periods, and/or portion of the cost that can be passed through.

For example, in the case of major capital replacement, with a 20-year amortization period, it is virtually certain that an expiration clause would have only a tiny impact because virtually all of the units would have become vacant prior to the time required to amortize the expense.

### **6. Whether Capital Improvement Allowances Are Added to Base Rent for the Purposes of Calculating Annual Allowable Increases**

Under some regulations capital improvement increases are separate surcharges which are not incorporated into the base rent, while under others, the increases become part of the base rent.

As a practical matter, assuming current trends in the CPI continue, including the increase in the base rent would result in adjusting the increase upward by about 3% a year. For example, if a \$50 capital improvement increase was granted, after three years, if the increase is added to the base rent, the increase may be adjusted by a total of 10% in annual increases (about \$55.)

#### E. Consideration of the Income of Tenant

Under the regulations of some jurisdictions, capital improvement increases are limited for units occupied by low income tenants. Santa Monica limits the allowable rent increase within a year for a low-income tenant to 12%. This ceiling may be contrasted with ceilings in other jurisdictions which limit overall annual increases for all tenants to 10% per year.

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<sup>1</sup> See Board packet of Dec. 20, 2017.

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Without addressing the issue of consideration of a tenant's income within a rent increase standard in detail, this author believes that the inclusion of such a standard in a rent regulation would raise a host of issues. One possibility is that it could result in a disincentive to rent to low income tenants. Other issues would emerge about the design of such a standard (e.g. would assets be weighed and, if so, how?) and the administration of a tenant income verification process.

### F. "New" Improvements

A separate category of improvements are new items that were not present in a rental building on the base date such as a security system or a physical fitness facility. Allowable increases for these types of improvements are covered within the regulations governing "Changes in Space or Services" (Sec 904 (A)(2)).

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- automatically doubled prospectively if proof of correction of the violation is not submitted to the Rent Board within thirty-five (35) calendar days of mailing of the hearing examiner's decision unless the Landlord establishes that the violation cannot be corrected within that time due to circumstances beyond the Landlord's control.
- d. No rent shall be charged for a period in which the Landlord is found to be in violation of California Civil Code Section 1942.4.
  - e. For purposes of this subsection, a breach of the warranty of habitability occurs when the Rental Unit is not in substantial compliance with applicable building and housing code standards, which materially affect health and safety. Minor housing code violations which do not interfere with normal living requirements do not constitute a breach of the warranty of habitability.
- (5) Maximum Allowable Rent reductions pursuant to this Section shall be effective from the date the Landlord first had notice of the space or service reduction, deteriorated condition, service inadequacy, or code or habitability violation in question and shall terminate on the date of the first rent payment due after adequate proof has been submitted to the Board that the condition for which the reduction was granted no longer exists.
- (6) A Tenant who files a petition pursuant to this regulation must be able to establish the basis for the reduction and when the Landlord first received notice of the decreased service, deterioration, code violation or habitability violation. Notice may be actual or constructive. A Landlord is deemed to have notice of any condition existing at the inception of a tenancy that would have been disclosed by a reasonable inspection of the Rental Unit. A copy of a housing code inspection report from the City of Richmond should be submitted with the petition.

*[Adopted February 21, 2018]*

## **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 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

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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.

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

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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 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.
- 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.

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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.

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.

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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.

<b>Amortization of Capital Improvements</b>	
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
<i>Fencing</i>	

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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
<i>Landscaping</i>	
Planting	10
Sprinklers	10
Tree Replacement	10

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<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
<i>Security</i>	
Entry Telephone Intercom	10
Gates/Doors	10
Fencing	10
Alarms	10
Sidewalks/Walkways	10
Stairs	10

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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.
- 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
- 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.
- 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

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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.
- 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.
- 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.

*[Adopted March 21, 2018]*

**906-910 (RESERVED)**

**911. Overcharges and Other Violations**

- A. Overcharges: If on or after July 21, 2015, the Landlord has received rent in violation of the Ordinance, the Landlord shall be ordered to refund the overcharge. Any overcharge refund shall be paid to the person or persons overcharged, except as provided in Regulation 911(B), below. For purposes of this Regulation, any receipt or retention of rent, including security