

# AGENDA ITEM REQUEST FORM

Department: Rent Program

Department Head: Nicolas Traylor

Phone: 620-6564

Meeting Date: June 23, 2022

Final Decision Date Deadline: June 23, 2022

**STATEMENT OF THE ISSUE:** Section 11.100.070 of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance ("Rent Ordinance") provides that "landlords have a right to a reasonable return on their investment" or right to a fair return. The primary vehicle for achieving a "fair return" is the Annual General Adjustment, which, when applied to the Base Rent creates the Maximum Allow Rent level. When a landlord is not achieving a fair return by way of the Annual General Adjustment, the Ordinance allows landlords to petition the Board to increase the rent above the Maximum Allowable Rent. Such petition is made under Richmond Regulation 905, which measures a fair return by determining whether a Landlord has maintained their 2015 net operating income adjusted for inflation. Recently, Boardmembers have become concerned that the Covid-19 pandemic has impacted Landlords' ability to timely file their fair return petition. As a result, at its June 15, 2022, meeting, the Rent Board directed staff to hold a special meeting to study the Maintenance of Net Operating Income Standard, encapsulated in Regulation 905, and if appropriate, amend the Regulation to allow Landlords, who have been impacted by Covid-19, more time to file their fair return petition.

## 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 checked="" type="checkbox"/> Other: <u>STUDY SESSION</u> |
| <input type="checkbox"/> Contract/Agreement                                           | <input 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 presentation and study the Maintenance of Net Operating Income Standard and PROVIDE staff direction on possible amendments to Rent Board Regulation 905 (Nicolas Traylor/Charles Oshinuga 620-6564).

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**F-1.**

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# AGENDA REPORT

**DATE:** June 23, 2022  
**TO:** Members of the Rent Board  
**FROM:** Charles Oshinuga, General Counsel  
**SUBJECT:** Maintenance of Net Operating Income Study Session

## **STATEMENT OF THE ISSUE:**

Section 11.100.070 of the Fair Rent, Just Cause for Eviction, and Homeowner Protection Ordinance ("Rent Ordinance") provides that "landlords have a right to a reasonable return on their investment" or right to a fair return. The primary vehicle for achieving a "fair return" is the Annual General Adjustment, which, when applied to the Base Rent creates the Maximum Allow Rent level. When a landlord is not achieving a fair return by way of the Annual General Adjustment, the Ordinance allows landlords to petition the Board to increase the rent above the Maximum Allowable Rent. Such petition is made under Richmond Regulation 905, which measures a fair return by determining whether a Landlord has maintained their 2015 net operating income adjusted for inflation. Recently, Boardmembers have become concerned that the Covid-19 pandemic has impacted Landlords' ability to timely file their fair return petition. As a result, at its June 15, 2022, meeting, the Rent Board directed staff to hold a special meeting to study the Maintenance of Net Operating Income Standard, encapsulated in Regulation 905, and if appropriate, amend the Regulation to allow Landlords, who have been impacted by Covid-19, more time to file their fair return petition.

## **RECOMMENDED ACTION:**

RECEIVE a presentation and study the Maintenance of Net Operating Income Standard and PROVIDE staff direction on possible amendments to Rent Board Regulation 905 (Nicolas Traylor/Charles Oshinuga 620-6564).

## **FISCAL IMPACT:**

There is no fiscal impact related to this item.

## **DISCUSSION:**

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Receive a PowerPoint and oral presentation on the historical background and legal application of the Maintenance of New Operating Income Standard, as described in Richmond Rent Board Regulation 905.

### **DOCUMENTS ATTACHED:**

Attachment 1 – Rent Board Regulation 905

**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 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

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operating income which was formerly provided by a smaller number of units.

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

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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 be 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. 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.

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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.

The improvement is not an ordinary repair, replacement, and/or maintenance, and is necessary to bring the property into compliance or maintain compliance with applicable local code requirements affecting health and safety in accordance with Richmond Municipal Code Section 11.100.070(g).

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 and Expenses</b>	
In amortizing capital improvements, and/or expenses, the following schedule shall be used to determine the amortization period of the capital improvements and/or expenses	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

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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>	
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

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<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
<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>	

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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
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.

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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.
- 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

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

(8) Conditional Rent Adjustments for Proposed Capital Improvements

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

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

(10) Relationship of Individual Rent Adjustment to Annual General Adjustment

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

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

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

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

- 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.

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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; Amended August 15, 2018]*