

## DRAFT MEMORANDUM

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To: Honorable Mayor and Council, City of Beverly Hills

From: HR&A Advisors, Inc.

Date: July 26, 2018

Re: Rent Increase Application Process Policies in the Beverly Hills Rent Stabilization Context

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

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

### Statement of the Issue

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

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

<sup>2</sup> BHMC, Title 4, Chapter 5, Article 3, Section 4-5-401 and 4-5-402

<sup>3</sup> BHMC, Title 4, Chapter 6, Article 3, Section 4-6-11

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

### **The Current Beverly Hills Context**

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

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

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

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

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

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<sup>4</sup> See, for example, *Fisher v. City of Berkeley*, 37 Cal.3d 644, 679-686 (1981).

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

<sup>6</sup> BHMC, Title 4, Chapter 5, Article 3, Section 4-5-401

<sup>7</sup> BHMC, Title 4, Chapter 6, Section 4-6-11

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

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

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

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

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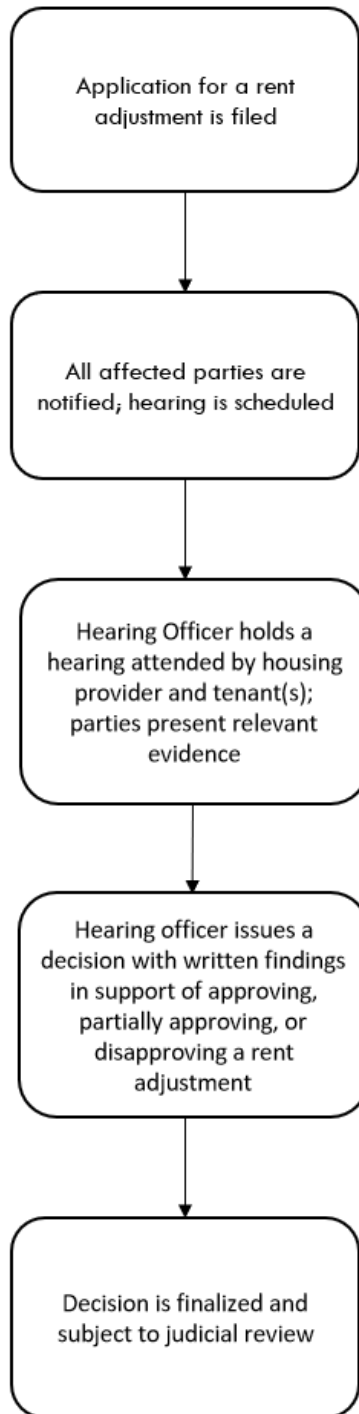
<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

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

<sup>11</sup> BHMC Title 4, Chapter 5, Section 4-5-401(c)

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



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

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

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

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

### **Facilitated Dialogue Sessions**

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

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

Further, tenant representatives stated that:

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

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<sup>12</sup> Beverly Hills Tenants Committee, 31-August-2017

a property to a prior state. The RSO should clarify that replacement of base amenities does not constitute improvement.<sup>13</sup>

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

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

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

### **Comparison with Other Cities in California**

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

### **Decision Maker Authority**

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

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

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

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<sup>13</sup> City Council Agenda Report with Summary of Facilitated Dialogues, 5-September-2017

<sup>14</sup> City Council Agenda Report with Summary of Facilitated Dialogues, 5-September-2017

<sup>15</sup> BHMC Title 4, Chapter 5, Section 4-5-401(c)

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

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

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

### Mediation

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

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

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

## Rent Control Boards

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

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

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

## Comparison of Rent Increase Application Process Steps

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

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

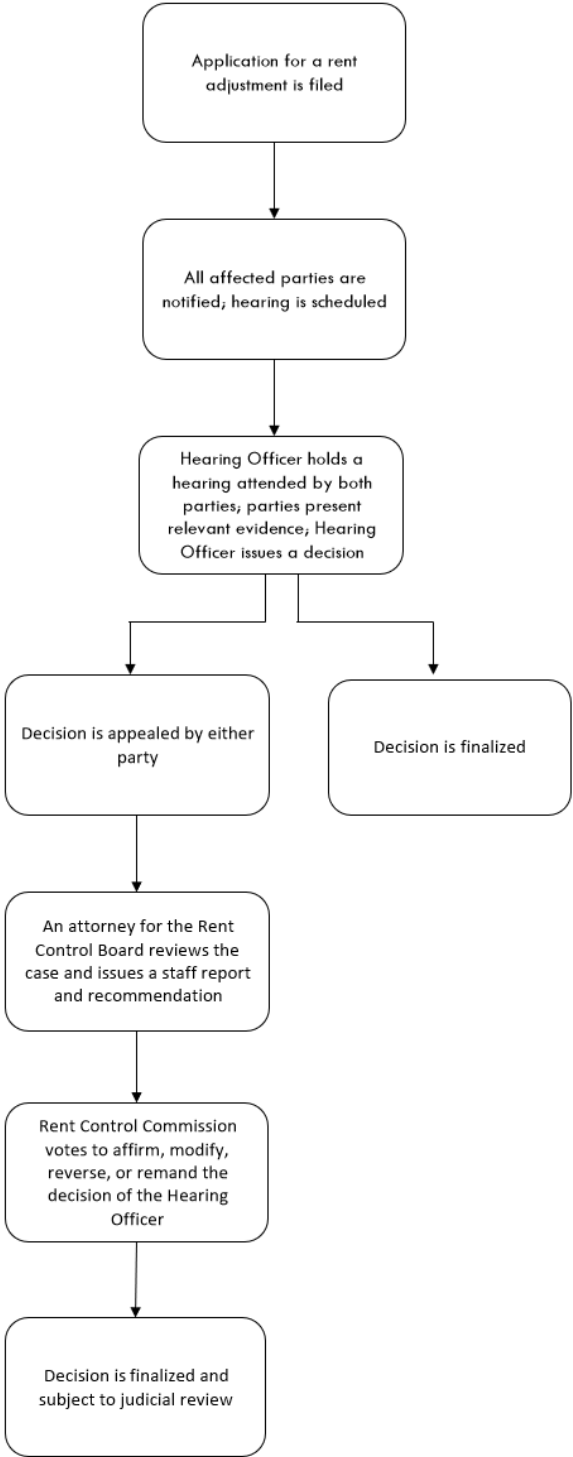
Figure 4 illustrates the Oakland application process, which differs from Beverly Hills in its inclusion of additional authorities, mediation services, and the response to appeals. Oakland's application process begins with the review of a petition by an administrative analyst, who decides whether to assign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

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

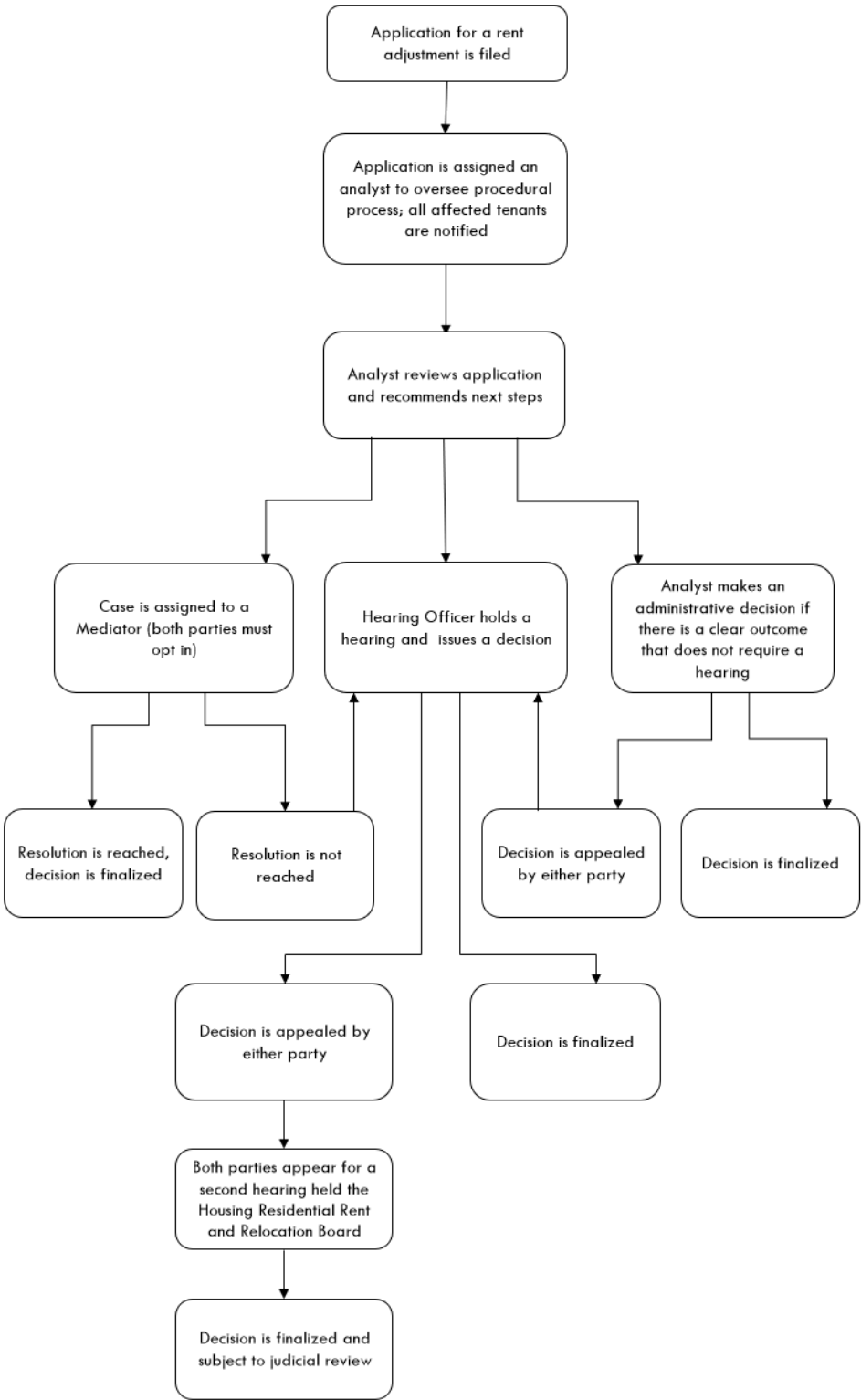


**Figure 3: Summary of Santa Monica Rent Increase Application Process (Hearing Officer, Attorney for Rent Control Board, Rent Control Board)**



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

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



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

## Rent Increase Considerations

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

### Base Year

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

**Figure 5: Comparison of Base Years for NOI**

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

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

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

### Operating Expense Categories

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

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<sup>17</sup> HCDLA, What is A Just and Reasonable Rent Increase?; <http://hcdla.lacity.org/blog/what-just-and-reasonable-rent-increase>

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

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

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

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

#### Debt Service Costs

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

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

#### Capital Improvements

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

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

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

### **Other Considerations in the Rent Increase Application Process**

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

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

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

## Policy Options for Beverly Hills

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

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

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

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

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

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

### 3. Create a Rent Control Board to Respond to Appeals of Hearing Officer Decisions:

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

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

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

**4. Provide Optional Mediation Services in Advance of the Hearing by a Hearing Officer:**

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

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

**5. Expand the Range of Factors Under Consideration in Rent Increase Application Process:** Under this option, considerations made when evaluating a rent increase petition would be expanded to include factors other than a housing provider's financials. Additional factors under consideration might include: the market-value of similar units, changes in housing services provided, or the physical condition of a rental unit as assessed by the hearing officer.

- **Benefits to housing providers:** If a housing provider has made improvements to a unit or increased housing services provided, the quality and not just the cost implications of those changes would be accounted for in the application process and fair return determination.
- **Disadvantages to housing providers:** Housing providers may be disadvantaged if the conditions of the unit that is the subject of a petition are not up to the standard of the rent increase that they are seeking.
- **Benefits to tenants:** Expanding the factors under consideration in the application process would benefit tenants by incorporating factors that impact them directly. This approach could require a formal inspection to distinguish between capital improvements and normal maintenance, which was a concern expressed by the tenants' group.
- **Disadvantages to tenants:** There would be little to no inherent disadvantages to tenants.

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



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