City of Culver City

Staff Report

File #: 21-169, **Version:** 1 **Item #:** A-1.

CC - (1) Continued Discussion of Rent Control and Tenant Protection Policies for Inclusion in a Permanent Program; and (2) Direction to the City Manager as Deemed Appropriate.

Meeting Date: August 17, 2020

Contact Person/Dept: Jesse Mays/City Manager's Office
Tevis Barnes/CDD/Housing Division
Heather Baker/City Attorney's Office

Phone Number: (310) 253-6000
(310) 253-5790
(310) 253-5660

Fiscal Impact: Yes [X] No [] **General Fund:** Yes [X] No []

Public Hearing: [] **Action Item:** [X] **Attachments:** []

Commission Action Required: Yes [] No [X] **Date:**

Public Notification: (E-Mail) Meetings and Agendas - City Council, Culver City News and Events, Housing Issues, Media Organizations, Press Organizations, Public Notifications (08/03/2020 and 08/12/2020); Landlord Tenant Mediation Board (07/29/2020 and 08/03/2020), Committee on Homelessness (07/28/2020 and 08/11/2020), Apartment Association of Greater Los Angeles, California Apartment Association, Protect Culver City Renters, and Protect Culver City (08/11/2020)

Department Approval: John Nachbar (08/11/2020)
Sol Blumenfeld (08/11/2020)

RECOMMENDATION

Staff recommends the City Council (1) continue its discussion regarding rent control and tenant protection policies for inclusion in a permanent program; and (2) provide direction to the City Manager as deemed appropriate.

In order to facilitate discussion and move through the numerous policy issues to be considered during this meeting, staff recommends the City Council follow the Ordinance Checklists attached to this report. Additional discussion of regarding each item may also be found in the Discussion section of this report.

BACKGROUND

At its August 12, 2019 meeting, the City Council adopted an urgency ordinance (Ordinance No. 2019-011) establishing interim rent control and tenant protection measures for a 12-month period ("Interim Rent Control Ordinance" or "IRCO") through August 11, 2020. On July 16, Ordinance No. 2019-011 was extended in its entirety, without amendment or modification of its terms, through October 31, 2020 (***Attachment 1***). The IRCO is included as Exhibit A to Attachment 1 of this report.

In conjunction with the preparation of the Interim Rent Control Ordinance, the City retained a qualified consultant, BAE Urban Economics ("BAE"), to conduct a rental housing market study, research rent cap urgency ordinances and prepare financial models of Culver City multifamily rental properties. BAE prepared a *Temporary Rent Cap and Relocation Assistance Policies Study* which was presented at the August 12, 2019 City Council meeting and helped to inform the City Council's decision, as it considered adoption of the IRCO.

As directed by the City Council on August 12, 2019, the City continued its engagement with BAE to develop a *Long-Term Rent Control Study* ("BAE Study") (***Attachment 2***). BAE built upon its prior *Temporary Rent Cap and Relocation Assistance Policies Study* in order to help the City better understand the Culver City rental market, the impacts of the IRCO, and options for and possible impacts of a future permanent rent control and tenant protections program ("Permanent Program").

On June 11, 2020, the City Council received a presentation of the BAE Study and commenced a policy discussion regarding a potential Permanent Program and what regulations and protections might be included. At that meeting, City Council expressed a desire to establish local rent control and tenant protection policies, which should include, at a minimum, the provisions of the IRCO, and directed staff to return with a menu of policy options for City Council's consideration.

At the July 16, 2020 special meeting, the City Council continued its discussion by going through Ordinance Checklists for both rent control and tenant protection measures for potential inclusion in a Permanent Program. The City Council reached a general consensus on a significant number of items and requested to continue its discussion on certain other items. Staff has prepared an updated Rent Control Program Ordinance Checklist (***Attachment 3***) and an updated Tenant Protections Ordinance Checklist (***Attachment 4***), which reflect the outstanding policy issues remaining for City Council's discussion and direction.

The following is a brief summary of the City Council's direction at the July 16th meeting, as well as the outstanding issues that still need to be addressed:

Tenant Protection Program:

There was general consensus by the City Council to include the following provisions in a Tenant Protection Program:

- Current IRCO tenant protections (*Please note, certain of the current IRCO provisions may need to be removed or modified to be consistent with State law, as discussed later in this report.*);

- Reduced relocation assistance payment for “mom and pop” landlords;
- Local anti-harassment provisions; and
- Six-month vesting period (eviction protections would not vest until six months after commencement of tenancy).

(*Note: Although staff received general direction on the above-listed items, the City Council may revisit any of these issues if they so choose*.)

In addition, the City Council determined to further discuss the following outstanding issues:

- Other For Cause Termination Grounds:
  - Unauthorized subletting
  - Adding additional adult occupants without permission
  - Recovery of manager unit because of termination of manager;
- How to address substantial renovations (i.e. recovery of unit allowed or temporary vacation with the payment of relocation assistance);
- Other “protected tenant” categories:
  - Low-income tenants;
- Timing of relocation assistance payment:
  - 50% within 5 days after notice of termination (current IRCO provision)
  - Other time period (i.e. 30% within 5 days after notice and 70% within 5 days of vacation);
- Amount of reduction of relocation assistance payment by “mom and pop” landlords;
- Voluntary Tenant Buyout (Such agreements are permissible. The issue is whether to establish local regulations governing them.); and
- Definition of “mom and pop” landlord.

These policy issues are also itemized in the Tenant Protections Program Ordinance Checklist, including sample provision(s) for some of the items, and discussed in further detail in the Discussion section of this report.

Rent Control Program:

There was general consensus by the City Council to include the current IRCO provisions in a Permanent Program.

The following categories pertaining to a rent control program remain outstanding:

- Additional Exemptions from Rent Control
- Permissible Rent Increases
- Allowable Pass-Throughs/Cost Recovery
- Fair and Reasonable Return Analysis

- Rent Registry

The specific policy issues within these categories on which the City Council should provide further direction are itemized in the Rent Control Program Ordinance Checklist and discussed in further detail in the Discussion section of this report.

State Law Limitations:

It is important to keep in mind certain limitations with regard to a local regulation. With regard to tenant protections, in accordance with AB 1482 (Civil Code Section 1946.2(g)(1)(B)), local tenant protection regulations may not be less protective of tenants than provided in state law. Regarding local rent control programs, a locally imposed cap on rents cannot be any higher than the cap under AB 1482. Apart from that limitation, AB 1482 (Civil Code section 1947.12(k)(2) and (3)) expressly reserves to the City the authority to establish its own rent control program.

DISCUSSION

After significant discussion and direction from the City Council at the July 16th meeting, the following items are the remaining policy issues for City Council's consideration.

TENANT PROTECTION PROGRAM:

The following are the policy issues for discussion as set forth in the Tenant Protection Ordinance Checklist.

1. *Additional For Cause Termination Grounds*:

- **Unauthorized subletting**: If assigning or subletting are addressed in a lease, this would be included in a breach of Material Rental Agreement Term, which is already For Cause grounds for eviction. If the City Council wants to allow eviction even if subletting is not addressed in the lease, a specific provision will need to be included in the tenant protection ordinance.
- **Adding additional adult occupants without permission**. See the Ordinance Checklist for sample provision(s).
- **Recovery of a manager unit because of termination of the manager:** This is addressed in State law, so any provision will need to be at least as restrictive.

2. *Additional No Fault Termination Grounds*:

- **Recovery of a rental unit in order to convert to affordable housing:** In reviewing this item in light of AB 1482, it appears State law does not allow for eviction on this basis; therefore, such a provision would be less protective than AB 1482 and is not recommended.
- **Substantial renovation:** Although there was not a consensus to include substantial renovation as No Fault grounds for eviction, there was interest in addressing it in the tenant protections program. See ***Attachment 5*** for more information regarding this issue and sample provision(s) the City Council may wish to consider.

3. *Protected Tenants Not Subject to No Fault Termination:*

- **Low-income tenants:** See Ordinance Checklist for sample provision(s).
- **Households with school-age children during the school year:** This item was not discussed by the City Council at the July 16th meeting; however, staff wanted to bring it to City Council's attention, as the Housing Division received one or two cases of parents who were facing eviction and were concerned about pulling their children out of school during the school year.

4. *Timing of Relocation Assistance Payment:* IRCO currently requires 50% within 5 days after notice of termination and 50% within 5 days after tenant's vacation of the unit. One Council Member wished to discuss the possibility of alternate timing requiring less up front and more after vacation of the unit (e.g. 30%/70%).

5. *Amount of Reduced Relocation Assistance Payment for "Mom and Pop" Landlords:* The City Council was interested in providing "Mom and Pop" landlords with a reduction in the relocation assistance payment for No Fault eviction; however, the amount of such reduction was not discussed. See below for policy consideration of the definition of "Mom and Pop" or small landlord. Also, see Ordinance Checklist for sample provision(s).

6. *Definition of "Mom and Pop" Landlord:* The City Council expressed an interest in further discussing certain exemptions or allowances for rental property owned by a "mom and pop" or small landlord. There are multiple options for defining a "mom and pop" landlord. See Ordinance Checklist for sample provision(s).

7. *Voluntary tenant buyout regulations:* Buyout agreements are permissible. The issue is whether City Council wants to establish local regulations governing them. See Ordinance Checklist for sample provision(s).

Changes to IRCO Tenant Protection Provisions: Staff has been in the process of reviewing and reevaluating the provisions of the IRCO, particularly in light of AB 1482, for inclusion in a draft ordinance for a Tenant Protection Program. As the result of such review, staff recommends the following issues be addressed:

- **Owner-occupancy No Fault evictions:** As previously mentioned in earlier staff reports and discussion, Housing staff has encountered cases of misuse or abuse of No Fault evictions based on occupancy of a rental unit by owner or owner's relative (collectively, "owner occupancy"). Staff is looking at ways to address these issues in the ordinance, which may include:
  - Applying the one-time limit for owner occupancy for a particular person across all rental units owned by the landlord, rather than in each rental complex.
  - For protected tenants (e.g. 62 years of age, disabled) who have not lived in their unit for 10 or more years, requiring that owner occupancy may only occur where owner or owner's relative is similarly situated to the tenant (i.e. if tenant is 62 years of age, then owner or owner's relative must also be 62 years of age, etc.)
  - Narrowing the category of individuals qualifying as owner's immediate family to remove brother, sister, father-in-law, mother-in-law, son-in-law, or daughter-in-law. (This change is also necessary because state law does not include these relatives under the No Fault

eviction provisions, so to include them in the City's local program would be less protective.)

- **Other grounds for No Fault evictions:** As previously noted, local tenant protections must be at least as protective as State law (AB 1482) tenant protections. There are no provisions in AB 1482 for a no fault eviction on the basis of recovering a unit for use and occupancy by: (1) a resident manager; or (2) a tenant that requires an occupancy agreement and intake, case management or counseling as part of the tenancy. If the City were to include such provisions, they would be less protective than AB 1482. These provisions should not be included in the draft ordinance.

If other issues arise during staff's continued work on drafting the ordinance, which require changes to IRCO provisions, those items will be identified when staff returns with the ordinance for City Council's consideration.

RENT CONTROL PROGRAM:

The following are the policy issues for discussion as set forth in the Rent Control Ordinance Checklist: (*Note: The term "Comparison Jurisdictions" as referenced herein below includes state law (AB 1482), the County of Los Angeles, and the cities of Beverly Hills, Los Angeles, Santa Monica and West Hollywood.*)

1. *Exemptions from Rent Control:* In addition to the units already exempt from rent control under the current IRCO, a few Council Members were interested in discussing the following potential exemptions:

- **Non-government subsidized affordable housing units (e.g. inclusionary units):** Government restricted affordable units such as units encumbered by income and affordable rent restriction provides a built-in cap on the rents that can be charged as defined by the Health and Safety Code. The City Council will be considering an Inclusionary Housing Ordinance in the near future, as a mechanism for addressing the Regional Housing Needs Assessment. One of the ways to incentivize the production of more affordable units is to exempt them from rent control. Of the Comparison Jurisdictions, only the State and West Hollywood exempt these types of units.

- **Single family residences that share a property with an accessory dwelling unit (ADU):** With regard to ADUs, state law regulations focus only on permitting and entitlements. The City has created the Affordable ADU Program to incentivize homeowners to build ADUs and rent them to workforce, low-income or homeless households. ADUs can help the City address the need for affordable housing stock. An exemption from rent control could serve as another incentive for property owners to consider building an ADU. None of the other Comparison Jurisdictions provide an exemption for this type of unit.

2. *Flexibility to Allow for Exemptions to Change as State Law Changes (e.g. Prop 21):* City Council was interested in including flexibility in the City's rent control program to allow for changes in existing law without having to amend the City's Code. Staff is still evaluating this

issue.

3. *Permissible Rent Increases:* Under the IRCO, the City has established a fixed percentage of 3% as the maximum allowable annual rent increase, with no variation based on change in CPI (defined below).

- ***Change in CPI:*** All Comparison Jurisdictions base the allowable annual rent increases *in part* on the annual change in the Consumer Price Index. For the regional Comparison Jurisdictions, the localized Consumer Price Index used is the Consumer Price Index for All Urban Consumers for the Los Angeles-Long Beach-Anaheim, CA area, published by the Bureau of Labor for a defined 12-month period ("CPI"). (For further details, see Attachment 2 - BAE Study, Page 26).

- ***Annual Average versus Year-over-year:*** Some Comparison Jurisdictions use the change in CPI "year-over-year" by comparing the CPI value in a specific month to the CPI value in the same month a year earlier. Other Comparison Jurisdictions define the change in CPI based on the annual average by comparing the average CPI for a specified 12-month period with the average CPI for that same period a year earlier. Each method has disadvantages: the "year-over-year" method can give disproportionate weight to months that frequently record higher or lower inflation than the annual average, while the "annual average" method results in utilizing CPI values that are up to two years old. (For further details, see Attachment 2 - BAE Study, Page 28).

- ***Guaranteed Minimum and/or Guaranteed Maximum:*** It is important to note that "guaranteed minimum" and "guaranteed maximum" do not mean that rents automatically increase every year.

  "Guaranteed minimum" rent adjustments protect landlords from periods of low inflation by setting a minimum rent increase threshold that would be allowed (but not required) even if CPI falls below such threshold. For example, a guaranteed minimum increase of 3% would be permissible even if the CPI for that period was less than 3%. The cities of Los Angeles and Beverly Hills guarantee a minimum rent adjustment of 3%; West Hollywood and Santa Monica do not provide for guaranteed minimums; and Los Angeles County has a more complicated formula for addressing guaranteed minimum rent increases during periods of low inflation. (For further details, see Attachment 2 - BAE Study, Page 27).

  "Guaranteed maximum" rent adjustments protect renters from periods of high inflation by setting a maximum rent increase ceiling that would be allowed even if CPI rises above such ceiling. For example, a guaranteed maximum of 5% would allow a landlord

to increase the rent by a maximum of 5% even if the CPI for that period exceeded 5%. All Comparison Jurisdictions utilize a guaranteed maximum: State AB 1482 - 10%; Los Angeles County and cities of Los Angeles and Beverly Hills - 8%; West Hollywood - 7%; Santa Monica - other formula setting a maximum dollar celling. (For further details, see Attachment 2 - BAE Study, Page 28).

4. *"Fair and Reasonable Return" Analysis:* Rent control restrictions must allow for a landlord to receive a "fair and reasonable return" with respect to the operation of the property on which the rental units are located.

- ***Method for evaluating "Fair and Reasonable Return"*:** Maintenance of Net Operating Income (NOI) is the standard used by all Comparison Jurisdictions to determine whether a landlord is able to obtain a fair and reasonable return. This is also the method utilized in the current IRCO.

  A landlord's NOI is revenues (e.g. rents, parking fees, etc.) minus expenses (e.g. utilities, gardening, etc.). NOI does not include interest, taxes, depreciation, or amortized mortgage expenses (explained later in the staff report). The method of Maintenance of NOI (MNOI) assumes that in the year leading up to the date the City adopted the IRCO (the "Base Year"), landlords were managing their revenues and expenses in such a manner that their NOI was providing them with a "fair and reasonable" return on the property. Therefore, in the future, maintenance of such NOI in an amount equal to or greater than the Base Year's NOI, adjusted for inflation, would also provide a fair and reasonable return. (For further details, see Attachment 2 - BAE Study, Page 30.)

The following are examples of the MNOI method for evaluating a fair and reasonable return:

Example 1: No Rent Cap

	Annual Inflation	Revenue	Expenses	NOI	NOI (in Base Year $)
Base Year	-	$100	$50	$50	$50
Year 1	10%	$110	$55	$55	$50

In Example 1, there is no rent control. Base year revenue is $100, expenses are $50, and NOI is $50. After one year, 10% inflation has caused expenses to go up by $5, but since there is no rent control the landlord has adjusted rents by the same amount of inflation, 10%, so the landlord's revenue is now $110, and NOI increases to $55. Note that NOI has increased by the same amount as inflation, which is 10%. Therefore, the landlord's NOI remains the same, adjusted for inflation. NOI has been "maintained".

If rent control is put in place, a landlord might file a petition with the City claiming he or she is unable to receive a fair and reasonable return due to rent control. Due to inflation, his or her expenses might be increasing at a rate higher than he or she is able to raise rents, causing his or her NOI to decrease or not keep up with inflation.

Example 2: 5% Rent Cap

	Annual Inflation	Revenue	Expenses	NOI	NOI (in Base Year $)
Base Year	-	$100	$50	$50	$50
Year 1	10%	$105	$55	$50	$45.45

In Example 2, there is rent control with a maximum annual rent increase of 5%. If annual inflation were again at 10%, then expenses in Year 1 would increase to $55. The landlord would only be able to raise rents a maximum of 5%, to $105. NOI is $50, the same as it was in the base year. Adjusted for inflation, the landlord's NOI has decreased--$50 in Year 1 dollars is only worth $45.45 in Base Year dollars, less than Base Year NOI of $50. In this case, since the City's rent cap has prevented the landlord from maintaining inflation adjusted NOI, the City might grant the landlord's petition to increase rents beyond the 5% cap, but only to an amount sufficient to maintain NOI adjusted for inflation.

- ***Structure of NOI Analysis***

  - CPI Adjustment: Full or Fractional*:* Most Comparison Jurisdictions evaluate a fair and reasonable return based on the full change in CPI. For example, under this method, if CPI has increased by 10% compared to the Base Year, a landlord's NOI should have also increased by at least 10% to at least maintain the Base Year NOI, adjusted for inflation, and be considered a fair return. Santa Monica and West Hollywood, however, evaluate a fair and reasonable return using a fraction of the change in CPI. For example, Santa Monica uses 40% of the change in CPI, and West Hollywood uses 60% of the change in CPI. For example, in West Hollywood, if CPI has increased by 10% compared to the base year, as long as NOI has increased 6% or more, the landlord is considered to be receiving a fair and reasonable return.

  - Mortgage Debt Service: No Comparison Jurisdiction includes mortgage debt service when analyzing NOI. As discussed earlier in the staff report, NOI does not take into consideration amortized mortgage expenses, interest, taxes, or depreciation. Each individual landlord has a unique tax and mortgage situation. Some landlords may have paid for the property entirely in cash, others may have financed the entire property, and among those who have mortgages, rates can vary differently. By setting aside those factors in an NOI analysis, it provides the clearest indication of real estate profitability and provides a way of comparing different project types with varying degrees of leverage.

  - Amortized Capital Improvements: Whether a jurisdiction includes amortized capital improvements in MNOI analysis generally depends on which method the jurisdiction uses to determine capital improvement pass throughs: (1) a cost recovery formula tied to the actual cost of the improvement; or (2) full NOI analysis. These two methodologies as they relate to capital improvement pass-throughs are discussed in further detail later in the staff report. Jurisdictions that have programs to allow for cost recovery for capital improvements generally do not allow amortized capital improvements to be considered during NOI analysis; jurisdictions that only allow for capital improvement passthrough after a full NOI analysis do allow amortized capital improvements to be considered when analyzing NOI.

  - Health and Safety Improvements Only versus All Improvements: Culver City's IRCO is

the only program among Comparison Jurisdictions that limits the amortized capital improvements considered during NOI analysis to only health and safety improvements. That limitation was put into place for the purpose of implementing the IRCO in the short term. Staff recommends that if the City Council allows amortized capital improvements to be considered during analysis of NOI, that such analysis include all capital improvements.

- Owner-performed Labor Costs for Maintenance: Nearly all Comparison Jurisdictions allow owner-performed labor costs for maintenance to be included as an expense for the purpose of calculating NOI. The City of Los Angeles allows such expenses to be considered only if the owner is a licensed contractor. Although these types of expenses are difficult to verify and might allow expenses to be exaggerated, jurisdictions mitigate these concerns by establishing set rates for reimbursement for owner-performed labor, as well as strict documentation requirements. See additional discussion in the *Owner Performed Labor* section, below.

5. *Allowable Pass-Throughs/Cost Recovery:*

- ***Eligibility Determination*:** As landlords make capital improvements to and pay certain other costs associated with their properties (new taxes, government mandated programs, etc.), they naturally want to recover the costs by passing-through part or all of the costs to their tenants. Cities with rent control guidelines have determined standards for when and how these costs may be passed through to tenants, either through (1) full NOI analysis (i.e. pass-through allowed only if landlord cannot maintain NOI through otherwise allowable rent increases); or (2) a cost recovery formula tied to actual cost of improvement (i.e. pass-through allowed regardless of NOI). The current IRCO uses full NOI analysis for determining pass-throughs. (For further details, analysis and examples, see Attachment 2 - BAE Study, Pages 40 - 53; and Attachment 6 - BAE West Hollywood Report, Page 5.)
  - Policy Considerations of the NOI Approach: Under the City's current IRCO, the City uses the full NOI analysis approach. The current Culver City Landlord Petition for Rent increase form (***Attachment 7***) shows the extent of the information that the City requires in order to accurately evaluate a landlord's NOI in order to determine the eligibility for pass through of health and safety related capital improvement costs. Completing the 22-page form as well as attaching receipts, bills, invoices, etc. takes a significant time for a landlord to complete and for the City to evaluate. At the end of the day, neither the landlord nor the City knows what the outcome will be and how much, if any, will be allowed to be passed through to tenants. A cost recovery methodology would take less staff and landlord time and resources and provide greater certainty during the process. This is especially important for citywide programs, such as seismic retrofit, where dozens or hundreds of properties citywide will be impacted.
  - Policy Considerations of the Cost Recovery Approach: BAE Recently completed a report for West Hollywood (***Attachment 6***) where it recommended that West Hollywood change from the existing full NOI analysis methodology to the cost recovery

methodology, for several reasons including: (1) NOI methodology may result in fewer capital improvement projects, which would impact the quality of the housing stock, including life/safety concerns; and (2) NOI methodology can be onerous, subjective and inconsistent. This cost recovery methodology is used by jurisdictions such as San Francisco, Los Angeles, and Beverly Hills. There are several benefits to the cost recovery method for determining pass-through eligibility:

- Robust cost recovery pass-through program can help alleviate concerns that a permanent rent control policy might be detrimental to the overall quality of the City's housing stock by reducing investment in critical building systems and infrastructure.
- Financial incentive for landlords to make capital improvements and incentivizes better practices (e.g. code compliance); thereby, maintaining or improving the quality of the housing stock.
- In general, pass-throughs (also referred to as tenant surcharges) are temporary and do not become part of the tenant's base rent.

(For further details, see Attachment 2 - BAE Report, Pages 40 - 41; and Attachment 6 - BAE West Hollywood report, Pages 24 - 26.)

- ***Types of Eligible Capital Improvements*:** While each Comparison Jurisdiction has its own definitions of costs that are eligible pass-through, they can generally be defined into two broad categories most relevant to Culver City: (1) government mandated improvements; and (2) voluntary capital improvements. A third category that may be considered is capital improvements related to tenant health and safety, which is the only category of allowable pass-through under the City's current IRCO. This strict limitation is not observed in any other Comparison Jurisdictions' permanent programs. As discussed in the BAE Report, an analysis of current Culver City building permits found that that the three types of capital improvements requested most often by multifamily properties within the City are voluntary seismic retrofitting, roof replacements and kitchen/bathroom remodels.
  - Government Mandated Improvements: Building improvements with a "government mandate" such as seismic retrofitting, restoration work following a natural disaster, and complying with a public agency order are often treated separately from "voluntary" capital improvements by Comparison Jurisdictions. For example, in the cities of Beverly Hills and San Francisco government mandated improvements are eligible for full cost recovery resulting in a 100% pass-through to tenant. Whereas, the City of Los Angeles allows full cost recovery on certain government ordered "rehabilitation work" , but only allows for a 50% cost pass-through for seismic retrofitting. (For further details, see Attachment 1 - BAE Report, Page 40. Also, see Pages 46-50 for a discussion of the potential impact of seismic retrofits and different pass-through scenarios).
  - Voluntary Capital Improvements: Every jurisdiction has a unique definition for voluntary capital improvements, but in general, voluntary capital improvements:

- are generally required to have a useful life of at least five years;
- must be permanently fixed in place (or relatively immobile);
- *do not* include "routine maintenance;"
- and do not result from a failure to perform regular repairs.

If a cost recovery program were to be used, the above criteria would be considered in determining whether a specific capital improvement would be eligible as a pass-through.

Of the Comparison Jurisdictions surveyed, Beverly Hills has the most generous pass-through program with respect to landlord cost recovery, including a 100% pass-through for voluntary improvements, irrespective of a building's size and/or number of units; while the City of Los Angeles and Los Angeles County only allow 50% pass-through. (For further details, see Attachment 1 - BAE Report, Page 40).

In the City of San Francisco, buildings with one to five units are also eligible for a 100% pass-through for voluntary capital improvements; whereas, buildings with six or more units are only eligible for a 50% pass-through.

- ***Period of Amortization of Costs*:** Amortization schedules correspond to the length of time over which eligible capital improvements may be recovered. Shorter amortization periods tend to favor property owners because they reduce the recovery period and allow for a higher monthly pass-through amount. Longer amortization periods tend to favor tenants, by reducing the monthly cost; however, if the amortization period is too long, the landlord may not be assured of recovering costs fast enough to make the improvement worthwhile.

  There are a few options for determining the amortization period for recovery of costs: (1) fixed period for each category of improvement e.g. 5, 10, 20 years established by ordinance, resolution, or administrative guideline; (2) reasonable life of the improvement (subject to staff approval); or (3) other variation based on category of improvements.

  The City of Santa Monica uses a fixed period for each specific type of improvement, and has a detailed amortization schedule in its municipal code which specifies, for example, that glass windows should be amortized over 5 years, air conditioners over 10 years, foundational replacement over 20 years, etc.

  The City of Beverly Hills similarly has codified a schedule, although less detailed, specifying 7- or 10-year amortization periods, depending on the type of improvement.

  The City of Culver City currently uses the "reasonable life of the improvement" methodology, which is less specific and allows staff to make the determination about the reasonable life of the improvement. This methodology was implemented in the interest of expediency during the implementation of the IRCO; however, in the long run a methodology that is more specific may allow for greater certainty for landlords, tenants, and the City.

Another variation based on category of improvement methodology may be used if the City Council desires to vary the amortization not by type of improvement but by broader categories, such as government mandated programs versus voluntary improvements.

- ***Other Allowable Costs to be Passed-Through/Recovered*:** Other pass-through costs the City Council may wish to consider include the following:

  - Capital Improvement Debt Service*:* When calculating a capital improvement pass-through, Comparison Jurisdictions generally allow landlords to add interest to improvement costs, provided they follow specific guidelines. The City of San Francisco, as well as the Comparison Jurisdictions of Beverly Hills and West Hollywood specifically allow the pass-through of capital improvement debt service. The City of Los Angeles allows a capital improvement surcharge to extend an additional year beyond the amortization period as a proxy for interest costs. Santa Monica does not allow the pass-through of capital improvement debt service.

  - Owner-performed labor costs: While relatively uncommon in practice, most Comparison Jurisdictions allow for owner-performed labor to be included when processing a pass-through application, provided certain guidelines are followed. In the City of Los Angeles, the property owner must first solicit at least two bids from unrelated contractors to be considered. Santa Monica and West Hollywood specify City-provided hourly labor rates for various types of owner-performed labor.

  - Capital improvement soft costs: The City of Los Angeles allows soft costs such as permitting fees, architect and engineering plans, and other similar costs to be passed through, provided a landlord provides sufficient documentation. The cites of City of San Francisco, Santa Monica and West Hollywood similarly allow soft costs to be passed through.

  - Voter approved taxes (e.g. parcel tax measures, certain property tax levies): Pass-throughs for voter-approved taxes are less common. Only two comparison jurisdictions, Santa Monica and Los Angeles County, offer some form of property tax pass-through. Los Angeles County and Santa Monica allow landlords to pass through to tenants five line-items on their property tax bills: the Community College Bond, the Unified Schools Bond, the Stormwater Management User Fee, the Clean Beaches and Ocean Parcel Tax, and the School District Special Tax.

  When determining whether to allow the pass-through of these various other costs, the City Council may wish to balance the landlords' desire to recover more costs (thereby incentivizing needed property improvements), versus the added cost burden to tenants of such improvements.

- ***Structure of pass-throughs in rent increases*:** When considering how to structure the pass-throughs with regard to the related rent increase, the City Council has the following options depending on the methodology used to determine pass-through eligibility:

  - Temporary Rent surcharge (until amortized costs are recovered)*:* When the cost-recovery methodology is used to determine pass-through eligibility, the allowable rent

surcharges are typically put in place only until the costs are recovered. This "temporary rent surcharge" policy should be considered if the City Council determines to use the cost-recovery methodology for allowable pass-throughs.

- Permanent Rent Increase*:* When the full NOI analysis approach is used to determine pass-through eligibility (i.e. pass-through allowed only if landlord cannot maintain NOI through otherwise allowable rent increases), then any resulting pass-through is permanent, and not a temporary rent surcharge. The "permanent rent increase" policy should be considered if the City Council determines to use the full NOI analysis methodology. Full NOI analysis is the established method under the current IRCO.

- Limitation on the Monthly Pass-through to tenant*:* If utilizing the cost recovery methodology for pass-through eligibility, the City Council may wish to consider establishing a maximum monthly pass-through amount to limit the potential burden on tenants. The policy can also benefit landlords by making policymakers more comfortable allowing a greater number of pass-throughs, by limiting the risk of very large rent increases for tenants. For example, Los Angeles City limits the pass-through surcharge to $55/month, Los Angeles County limits to 8% of the rent at the time of the petition, and San Francisco limits to 5% of the last year's rent or $30, whichever is greater. In the City of Beverly Hills, the monthly surcharge cannot exceed 4% of the base rent at the time of the petition. When the amortized capital improvement cost exceeds the maximum allowable surcharge amount, the surcharge period is generally extended to allow the entire repayment of the tenants' share of the capital improvement. (See Attachment 2 - BAE Report, Page 50, for an example of how capping a temporary surcharge could work.)

- Hardship exemption to pass-through for low-income tenants*:* Hardship exemptions to pass-throughs for low-income tenants are seen in a limited number of specific situations in other jurisdictions. For example, in Santa Monica, low-income tenants may get an exemption from the pass-through of the Clean Beaches and Ocean Parcel Tax, and Section 8 tenants and very low-income seniors or disabled tenants can apply for fee waivers from the rental registration fee pass-through. Similarly, West Hollywood exempts Section 8 tenants, and owner or relative-occupied units from the rental registration fee pass-through. At its meeting of July 16th, the City Council discussed the possibility of a 50% pass-through of the rental registration fee for small "mom and pop" landlords.

6. *Rent Registry Items*:

- ***Whether to require information regarding what housing services are included in the rent:*** With the exception of the State, which doesn't have a rent registration requirement, all other Comparison Jurisdictions require this information to be included in landlord's rent registration form.

- ***Registration updates:*** The following is a breakdown of when Comparison Jurisdictions require a landlord to update their rental registry.
  - Annually: Beverly Hills, LA County and LA City
  - Upon New Tenancies: Beverly Hills, Santa Monica and West Hollywood
  - Upon Changes in Services/Amenities: Santa Monica and West Hollywood

- ***Fee:*** There was a general consensus among City Council to charge a fee; however, there is still the outstanding issue of what percentage of the fee a landlord may pass-through to the tenant. Some Council Members wanted to further discuss passing through only 50% of the registration fee to "mom and pop" landlords, but 100% of the fee to all other landlords. (See also discussion regarding "mom and pop" definition and allowable pass-throughs above.)

NEXT STEPS:

Staff recommends the City Council discuss the policy issues itemized in the updated Ordinance Checklists and provide direction to staff as deemed appropriate.

It is anticipated that staff will return to City Council on September 14, 2020 with proposed ordinances consistent with City Council's policy direction.

FISCAL ANALYSIS

Cost is an important consideration when designing a permanent rent control and tenant protections program. If the existing interim rent control and tenant protections program was made permanent, it would be expected to cost approximately $450,000 annually, including the cost of staff time and consultants. Additional program features would add additional costs. A scaled-down program would reduce costs, although not entirely. The annual cost of a program similar to the existing IRCO could increase by an estimated $100,000 should landlords submit a significant number of petitions for rent increases. The $450,000 annual cost projection also assumes that existing Housing Division staff will continue to dedicate a significant portion of their time on the program, which reduces the amount of time they have to spend on other programs. The cost of the program could increase by an additional $100,000 to $200,000 should an additional staff member be required to administer the program. For example, should the City need to process a significant number of capital improvement pass through requests, or other new program features, an additional staff member may be required. Therefore, the total annual cost of a permanent rent control program could range between $450,000 and $850,000, depending on which features are selected by City Council.

Depending on the total cost of the program, the City Council could approve new fees that could raise revenue to cover a significant portion of the cost of the program through a per-unit cost-recovery fee charged annually to the landlord (and depending on City Council direction, partially passed-through to the tenant). Most cities with rent control charge a per-unit fee to register rental units, and allow landlords to pass-through 50% of the registration fee to tenants. For example, Santa Monica charges an annual fee of $198/unit, and West Hollywood's annual fee is $144/unit. Based on Census estimates, there are approximately 7,555 rental units in Culver City. Of those, 5,658 units have been registered with the City during IRCO as part of the registration requirement as of July 20, 2020. A fee

of $88/unit in Culver City charged to each of the 5,658 registered units would raise approximately $497,992 annually. A fee of $165/unit would raise approximately $933,735 annually. City Council would have to consider the economic impact on a new fee that would result in additional costs to landlords and possibly tenants. Any fee would be considered at a future City Council meeting.

As noted in the BAE report (p. 56), other nearby jurisdictions have significantly higher costs for their rent control programs. Santa Monica and West Hollywood have annual rent control budgets of $4.75 million and $2.2 million respectively. Both communities have more rental units than Culver City (27,445 in Santa Monica and 16,895 in West Hollywood compared to estimated 7,555 in Culver City).

ATTACHMENTS

1. 2020-08-17_ATT 1_Urgency Ordinance Extending IRCO
2. 2020-08-17_ATT 2_BAE Urban Economics Study
3. 2020-08-17_ATT 3_Tenant Protections Ordinance Checklist
4. 2020-08-17_ATT 4_Rent Control Ordinance Checklist
5. 2020-08-17_ATT 5_Sample Provisions for Substantial Renovations
6. 2020-08-17_ATT 6_BAE West Hollywood Report
7. 2020-08-17_ATT 7_Culver City Landlord Petition Form

MOTION

That the City Council:

1. Discuss rent control and tenant protection policies for inclusion in a permanent program; and

2. Provide direction to the City Manager as deemed appropriate.