



City of Alameda

Staff Report

File Number:2021-8337

City Council

Agenda Date: 1/19/2021

File Type: Regular Agenda Item

Agenda Number: 6-B

Introduction of Ordinance Amending the Alameda Municipal Code by Amending Article XV (Rent Control, Limitations on Evictions and Relocation Payments to Certain Displaced Tenants) to Adopt and Incorporate Provisions Concerning Capital Improvement Plans (CIP) for Rental Units in the City of Alameda. (Community Development 265)

To: Honorable Mayor and Members of the Alameda City Council

EXECUTIVE SUMMARY

In September 2019, as part of adopting an ordinance to revise and restate the City's rent control ordinance, City Council requested that staff re-visit the Capital Improvement Plan (CIP) Policy that City Council adopted by resolution in April 2016, and that had not been revisited or revised since that time. Since April 2016, the Rent Program has received eight applications for capital improvement plans and approved only two, suggesting that the current Policy may not have had its intended effect.

The proposed amendment to the Rent Ordinance (Attachment 1) would embody the salient portions of the existing Policy into the Ordinance with some revisions. For example, it would permit a landlord to "pass-through" the amortized cost of major improvements (defined in the amendment) assuming the cost of the improvements to be amortized is no less than \$25,000 and the cost to each rental unit is no less than \$2,500. No pass-through would be greater than 5% of a tenant's current rent and annual general adjustments (annual rent increases) would be calculated without regard to the pass through amount. Pass-throughs would be eliminated for new tenancies (vacancy decontrol).

Tenants would be displaced temporarily only if the work associated with the capital improvements could not be accomplished with the tenant safely remaining in the rental unit; landlords would be required to make temporary relocation payments in that instance.

A tenant would know before any work started what would be the amount of the "pass-through" and the pass-through amount would be fixed, i.e., it could not be increased even if the work costs more than the landlord anticipated. A tenant could also inform the landlord that the landlord must make a choice not to impose the pass-through as to that tenant, make permanent relocation payments to the tenant or withdraw the application.

This Ordinance will not affect the current eviction moratorium, even for a temporary relocation, unless

City Council

Agenda Date: 1/19/2021

File Type: Regular Agenda Item

Agenda Number: 6-B

temporary relocation is absolutely necessary for health or safety reasons. It would, however, allow for a pass through during the rent freeze moratorium as a pass-through is not a considered a rent increase.

BACKGROUND

In April 2016, following the City Council's adoption of a comprehensive rent stabilization ordinance, City Council adopted by resolution a CIP Policy. (Exhibit 1) The purpose of the Policy was to encourage landlords to improve the quality of the City's housing stock, to ensure landlords a fair return on investment, and not to displace tenants from their homes unreasonably. Under the Policy, if a landlord made major improvements or repairs to the rental property, the cost could be amortized over 15 years and recovered from tenants as a rent increase. Tenants displaced by reason of the improvement work, whether temporarily or permanently, would receive relocation payments.

Landlords, however, have not utilized this Policy; in the four and a half years since the Policy was adopted, the Rent Program has received only eight applications for a CIP. Anecdotally, staff has been informed that the cost threshold requirements of the Policy-the cost of the improvements must be at least eight times the monthly rent times the number of rental units-is too high. As a result, the goal of ensuring the long-term viability of the City's rental housing stock may not be served by the existing Policy.

In September 2019, as part of adopting an ordinance to revise and restate the City's rent stabilization program, City Council requested that staff re-visit the Capital Improvement Policy, meet with stakeholders, and return to Council with any proposed changes to the Policy.

It should be noted that while staff is recommending changes to the CIP provisions, these changes are long-term and do not change the current local emergency declaration and eviction moratorium that prohibits landlords from temporarily or permanently relocating tenants as a result of an approved CIP (or for any other reason) unless a temporary relocation of a tenant is absolutely needed for health or safety purposes.

DISCUSSION

CIP's are intended to encourage landlords to improve the quality of the City's rental housing stock, to ensure landlords receive a fair return on property, and not to displace tenants unreasonably. This purpose continues to inform the proposed amendments to the Rent Ordinance.

Staff is recommending that the City Council introduce an ordinance that would incorporate into the Rent Ordinance the salient portions of the proposed Policy. Other provisions of the proposed Policy would be promulgated through the Rent Program Regulations. To the extent the Ordinance revises the existing Policy, Exhibit 2 of the staff report is a table that summarizes the revisions and the reasons therefor. The table includes each issue (definition of a capital improvement, pass-through

City Council

Agenda Date: 1/19/2021

File Type: Regular Agenda Item

Agenda Number: 6-B

limitations, amortization schedule, temporary and permanent relocation, etc.), the existing policy, the proposed change and why the proposed change is being recommended.

When City Council directed staff to re-evaluate the current CIP Policy, it also directed staff to engage with stakeholders as part of the process for recommending changes. Staff prepared revisions which it presented to landlord and tenant representatives in August 2020. Based on the feedback received at that meeting, staff made a number of revisions including:

- Reducing the cap on the permitted pass-through from 10% to 5%
- Increasing the threshold to qualify as a capital improvement from \$250 per unit to a minimum total cost of \$25,000 and \$2,500 per unit
- Adding tenant notification requirements of a proposed capital improvement project
- Fixing the amount of the pass-through before any work begins so that a tenant may make an informed decision whether to remain in the unit after the work is done or receive permanent relocation payments to find other housing
- Permitting all landlords to recover 100% of the cost of the improvements (the draft that had been discussed with the stakeholders group in August provided that landlords with five or more units could recover only 70%) as those costs are established before the work begins
- Adding an appeal process for certain City determinations, such as whether it is necessary that a tenant be temporarily relocated due to the capital improvement work

Staff believes with these revisions, the revised capital improvement provisions provides additional assurances that tenants will not be displaced from their homes as a result of capital improvement work while continuing to provide assurances to landlords that they will recover their costs for capital improvements made to their property.

Including Capital Improvement Work as Part of a “Fair Return on Property” Petition

Tenant representatives also requested that the City consider a CIP Policy that would include the amortized cost of the capital improvement work only in the context of ensuring a fair rate of return. The landlord representatives did not support this approach, indicating that such a process would act as a disincentive rather than an incentive to undertake such improvements and that it would be a very burdensome process for smaller landlords.

As proposed, the Ordinance provides for a Pass-Through of the amortized cost of the improvement which is in addition to a tenant’s Maximum Allowable Rent. This method is consistent with what other rent control jurisdictions, such as San Francisco and Oakland use. Some rent control jurisdictions, however, require that capital improvement costs, as amortized, be recovered only as part of a “fair return” process.

Agenda Date: 1/19/2021

File Type: Regular Agenda Item

Agenda Number: 6-B

In rent controlled jurisdictions, landlords are entitled under the Constitution to receive a fair return on property. There are several ways that a landlord may demonstrate what is a fair return on property but the most common method, and the one routinely accepted by the courts, is the maintenance of net operating income (MNOI) method. Under this method, a landlord's net operating income (gross revenues minus certain enumerated expenses) in the year before rent control (base year) is compared to the landlord's current net operating income. If the current net operating income, adjusted for inflation, is less than the net operating income for the base year, the landlord is entitled to a rent increase in order to maintain the base year's net operating income.

In those rent controlled jurisdictions that permit recovery of the cost of capital improvements only as an expense, the amortized cost of the capital improvement becomes an expense for the current year that, along with the other authorized expenses, is then deducted from the income to yield a net operating income. Depending on other expenses, folding the amortized cost of capital improvements into the expense column may result in a rent increase above the Annual General Adjustment, although most jurisdictions put a cap on the percentage of a rent increase that may be imposed in any one year. For example, if, in order to obtain a fair return, a landlord would be entitled to a 7% rent increase but the jurisdiction had a 5% cap on annual increases, a landlord would be able to increase rents by only 5% in the first year, with the additional 2% recovered the following year.

For the following reasons, staff is not recommending that the cost of capital improvements be part of the MNOI method at this time:

- Typically, the type of improvements that are included as capital improvements under the MNOI method include improvements that have relatively short useful lives and often include fixtures, such as refrigerators and doors, that staff believes are not truly capital improvements. Moreover, the Ordinance, as proposed, limits the amount of the pass-through to no more than 5% of a tenant's current rent, which is similar to how some rent control jurisdictions limit rent increases when capital improvements are expense items.
- Under the MNOI method capital improvements expense items result in rent increases upon which future AGA's are based. The proposed Ordinance treats a pass-through as separate items and annual AGA's are based on Maximum Allowable Rents that do not include pass-through amounts.
- Unlike the proposed Ordinance that would generally be implemented by Rent Program staff, an MNOI-based policy would need to be handled by hearing officers who have the expertise to review and understand the complex MNOI calculation in order to render a decision on these cases. Using hearing officers add to the cost of the Rent Program, which is borne by landlords and tenants alike.
- An MNOI-based policy could result in fewer capital improvement projects, thus impacting the long-term viability of the City's rental housing stock.

ALTERNATIVES

City Council

Agenda Date: 1/19/2021

File Type: Regular Agenda Item

Agenda Number: 6-B

- Introduce an Ordinance revising Capital Improvement Plan provisions.
- Provide direction to staff regarding any changes to the proposed Ordinance.
- Decline to move forward with the proposed Ordinance and direct staff to prepare an Ordinance that provides for the recovery of the cost of capital improvement work only in the context of a fair return petition (the MNOI method).
- Decline to revise the existing CIP Policy at this time.

FINANCIAL IMPACT

There is no financial impact to the Rent Stabilization Fund from revising the CIP provisions for rental units as the cost of administering the program, including the proposed amendments, is included in the previously appropriated Rent Stabilization budget.

MUNICIPAL CODE/POLICY DOCUMENT CROSS REFERENCE

This amendment would further the purposes of the Rent Control Ordinance, provides a method for landlords to recover their costs for capital improvements, and protects tenants from unreasonable displacement from their homes.

ENVIRONMENTAL REVIEW

Introduction (and eventual adoption) of this Ordinance is exempt from review under the California Environmental Quality Act (CEQA) under CEQA Guidelines section 15378 (b)(2) and (b)(5) (not a project) and Section 15061 (b)(3) (no significant environmental impact).

CLIMATE IMPACTS

There are no identifiable climate impacts or climate action opportunities associated with the subject of this report.

RECOMMENDATION

Introduce an Ordinance revising provisions concerning Capital Improvement Plans for rental units in the City of Alameda.

CITY MANAGER RECOMMENDATION

In addition to the staff recommendation and alternative options, the City Council could consider if adopted the timing of when the Resolution becomes effective.

City Council

Agenda Date: 1/19/2021

File Type: Regular Agenda Item

Agenda Number: 6-B

Respectfully submitted,
Lisa Maxwell, Interim Community Development Director
Michael Roush, Special Counsel

Financial Impact section reviewed by,
Annie To, Finance Director

Exhibits:

1. Existing CIP Policy
2. CIP Table

cc: Eric Levitt, City Manager