

## 1985 ANNUAL REPORT

### INTRODUCTION

The Rent Control Law, contained in Chapter 18 of the Santa Monica City Charter, calls for an annual report to the City Council on the status of controlled rental housing. In 1985, the 1984 amendments by the voters to the Rent Control Law were first being implemented and litigation was successfully concluded that upheld the exercise of powers granted to the Rent Control Board in the Charter. It was a year with many new developments.

In 1985, the availability of rental housing was influenced by the Law's regulation of removals of rental housing and the impact of new exemptions. The newly amended Rent Control Law affected these issues, as did litigation and state legislation. The status of newly converted condominiums as controlled rental units was finally clarified in a number of court decisions.

Affordability of rental housing was maintained with an innovation in the general adjustment to provide larger annual

adjustments to those landlords who pay for gas and electricity in master-metered buildings. Rent surcharges to pay for the costs of streetlights and school taxes continued to be implemented as well in 1985. Such surcharges were developed to allocate such costs in a more targeted manner than a general adjustment, but through a less expensive process for the agency than individual increase petitions. The Board also relaxed a regulation which had limited the amount of annual rent increases to twice the wage inflation rate when the wage inflation rate shrank to only 4.2%. A study of the demographic characteristics showed that stabilized rent levels enabled the population of the city to remain diverse in income levels, age and ethnicity.

Another goal that was addressed in 1985 was the concern for housing quality. A one-year pilot program to provide rent increases, with the consent of affected tenants, for replacements and upgrades of such interior items as appliances and cabinets was put into effect. In an effort to determine whether housing quality is being affected by rent limits, the Board has begun a search for a survey approach that will produce reliable information about the maintenance needs of the housing stock. Meanwhile, the Board's powers to order

rent decreases when housing quality deteriorates were upheld by the Court of Appeals. This ruling overturned a lower court's order that had temporarily halted action on tenants' complaints of substandard housing conditions.

### AVAILABILITY OF CONTROLLED RENTAL HOUSING

#### Removals of Rental Housing

The 1984 Charter Amendment to the Rent Control Law clarified the circumstances when housing may be removed from the rental housing stock to be demolished or converted to another use. The new law deleted the requirement that findings be made that the proposed removal not affect low income tenants or the supply of affordable housing. The Rent Control Law permits landlords to obtain a permit from the Board to remove their property from the residential rental housing market and use it for some other purpose provided certain facts are shown. Removal permits are given in the following circumstances:

\* When the maximum allowable rent cannot be collected on the property;

\* When, even with all permissible increases in the maximum allowable rent, the landlord cannot make a fair return;

\* When the property is uninhabitable and not capable of being rehabilitated in an economically feasible manner;

\*When removal of units is sought for the purpose of developing the property with new multi-unit dwellings and 15% of the new units will be affordable to low income persons and the existing tenants are assisted with relocation; and

\*When removal is sought in good faith by the owner of a three unit or less owner-occupied structure who has resided there for one year or more.

In 1985, twelve applications for removals were approved by the Board. Four of the applications, involving 36 units, were due to uninhabitability. Eight of the applications were for development of the sites, resulting in Board approval to remove 43 existing units and build 132 new units, a net gain of 89 units. Nine owner-occupant triplex removals were granted by staff as well. Two factors have favorably influenced the increase in development activity in 1985. The lower interest

rates have caused an increase in rental housing development statewide. Also, the formation of Community Corporation, which develops and administers housing programs for low and moderate income people, has facilitated the planning for inclusionary housing in the development process.

Litigation over the authority of the City to regulate the removal process came to a successful conclusion in 1985. The California Supreme Court upheld the removal restrictions in the Rent Control Law in the case of Nash v. Santa Monica in late 1984; Nash appealed to the United States Supreme Court and the Court dismissed the appeal for lack of a substantial federal question on March 18, 1985. This made the Nash decision final. Nash was a landlord who claimed a right to "go out of business" by evicting his tenants and demolishing his building without a removal permit from the Rent Control Board even while he claimed to be making a fair return on his investment. The California Supreme Court found that removal regulations served important public objectives and only minimally burdened Nash's interest in ending his duties as a landlord because he remained free to sell the property or delegate those duties to a property manager or withhold rental units from the market as they become vacant.

The issue of whether removal regulations could extend to apartments being converted to condominiums was finally resolved by the Court of Appeals in two 1985 cases. In McMullen v. Santa Monica Rent Control Board, the Court of Appeals stated that removal regulations may be imposed independent of the subdivision process (to convert to condominiums) though they may not halt the subdivision itself. Shortly thereafter, in Blue Chip Properties v. Permanent Rent Control Board of the City of Santa Monica, the Court of Appeals stated that the tentative approval of a project under the Subdivision Map Act did not vest the developer with the right to remove a unit from the rental housing stock because property may be subdivided and sold without disturbing its character as rental housing. Thus it is now clear from the courts that removal permits may be required when condominium conversions are completed before the unit is removed from the rental housing stock.

The requirement that replacement housing be on the same site in removals for the purpose of development was brought to court in 1985 in Scarborough v. Santa Monica Rent Control Board. In that case, the developers proposed building the replacement housing in a different neighborhood. The Court

of Appeals upheld this requirement and the case is now before the California Supreme Court for review. A decision is expected in 1986.

In reaction to the decision in Nash v. Santa Monica Rent Control Board, the State Legislature enacted Senate Bill 505 (the "Ellis Bill"), which appears to limit the extent to which cities may regulate a landlord's decision to evict all the tenants in a property and go out of business as a landlord. The new law will be effective July 1, 1986; until then it will not be clear how much it will diminish the rental housing stock in Santa Monica. The Ellis Bill does permit for local regulations and ordinances to govern abuses of its provisions. An example of such an abuse would be a landlord's eviction of a tenant under Ellis only to re-rent to a new tenant a few months later. Regulations will be adopted to govern such situations prior to the July 1986.

#### Exemptions

The 1984 amendments to the Rent Control Law created a new automatic exemption for single family homes that were not used as rental purposes on July 1, 1984. While this exemption,

unlike all other exemptions, does not require application to the Rent Control Board, the Board has been accepting written declarations from owners of such single family homes for its records so that the status of such homes is clear in the public records. Two hundred and eighty-five declarations of exemption as single family homes were received in 1985. It is not known how many single family homes which are now being used for rental purposes became automatically exempt under this provision.

There were 90 other exemption applications in 1985 under the new law's requirement that exemptions be subject to Board approval. Eighty-seven of these applications were granted.

#### AFFORDABILITY

Between 1970 and 1980, rents increased an average of 12.5% per year in Santa Monica, while income increased an average of 10.9% per year. (Source: census data.) During the same time period, median home prices in Santa Monica increased from \$36,300 to \$189,800. Since the Rent Control Law was enacted in 1979, the rate of increase in rents has been slowed

to an average of 6% per year. (Larger increases are granted in individual increase hearings.) Rent limits in Santa Monica have kept the median rent for Santa Monica at approximately the same amount as the 1985 statewide median rent of about \$425.

In 1985, the general adjustment was, for the first time, targeted to reflect differences in cost between landlords with master-metered buildings and those whose tenants pay for their own gas and electricity. The general adjustment was set at 3%, effective September 1, 1985. However, landlords who paid for the cost of electricity for the units got an additional .5% increase. Landlords who paid for the cost of gas for the units got an additional 1% increase. Therefore, landlords with fully master-metered buildings would be entitled to a general adjustment of 4.5%. By the end of 1985, 275 master-metered applications had been submitted and 27 had been denied. These applications were denied because the applicants were paying gas or electricity for common areas, not for individual units.

The amount of the general adjustment was determined after public hearings and discussion of a number of different studies. One such study documented the amount of cost

increases affecting the operating expenses and net operating income for rental properties in Santa Monica, based on the cumulative cost increases since the base year. That study showed that cost increases and allowance for increase in profits would require a general adjustment of less than one percent, just .4%. The 1984 general adjustment had included a 1.75% one-time maintenance incentive adjustment, thereby raising the general adjustment from the 2.25% produced by the cost increase formula to 4%. This one-time increase effected the calculation of the 1985 cumulative cost figures. A second study focused only on increases that had occurred in the year prior to April 1985; this yielded an increase amount of 3%. The Board also considered using a multiple of the inflation rate, which had been 4.6% the preceding year.

When landlords wish to obtain increases greater than the general adjustments, individual increase petitions may be filed. In 1985, only 97 increase petitions were filed, representing less than two percent of the controlled rental properties. This figure suggests that the general adjustments in 1984 and 1985 were adequate to compensate the large majority of landlords for increases in costs and profit.

The slowing of the inflation rate in 1985 also led to a change in one of the regulations governing individual adjustments. That regulation limited the amount rent could rise in a given year to twice the Employment Cost Index (a statistic representing wage inflation), in order to stabilize the rate of growth in rents to minimize displacement. However, the Employment Cost Index shrank to only 4.1% in 1985 and the resulting 8.2% annual limit on rent increases created unintended problems. The Board therefore amended the regulation to create a 12% alternative to the Employment Cost Index multiple, so that in years with low inflation, rents could increase as much as 12% per year as a result of individual adjustment petitions.

In three areas, rent surcharges had been developed to pay for new costs that affected a large but identifiable number of properties as an alternative to individual adjustment hearings or consideration in the general adjustment. A surcharge of two dollars per month to pay for the cost of installing smoke detectors was imposed in 1982 that expired in August 1983. In July 1984, a surcharge procedure for residential street lighting was created so that tenant-initiated street lighting improvements could be paid

through rent surcharges. In this program, the Rent Control staff works with the General Services department to implement the surcharge. Four neighborhoods in 1985 had surcharges approved, affecting almost one thousand units. The school tax surcharge, to recover the cost of the special emergency school tax, was originally imposed for an eight month period in 1984, to expire in August 1985. This program was continued, with some modification, through 1989.

In late 1984, the California Supreme Court upheld Berkeley's rent control law against a facial attack in Fisher v. City of Berkeley. The case was then appealed in 1985 to the United States Supreme Court, and the court accepted the appeal for purposes of reviewing only the federal antitrust question. All the other issues became final. Thus, Berkeley's rent increase formula, which is similar to Santa Monica's formula (though permitting smaller increases in profits) was upheld against constitutional attack because the formula was flexible enough to enable the Rent Control Board to avoid confiscatory results.

#### HOUSING QUALITY

The Rent Control Law was originally structured to

encourage maintenance of the housing stock by considering that maintenance and the cost of the maintenance in making both individual and general adjustments to rent. Section 1805(e). In fact, a landlord must substantially comply with applicable state or local housing and health laws before he may increase rent at all. Section 1805(h)(2). When the electorate amended the Rent Control Law in 1984, this section was expanded to require the landlord's certification of such compliance on any rent increase notice and to expressly authorize tenants to withhold rent increases when the landlord fails to comply.

The Rent Control Law and regulations also permit rent increases greater than those allowed in the general adjustment when operating costs and capital improvements increase faster than increases in rent from the general adjustment. In 1984, the general adjustment was modified to a larger amount (from 2.25% to 4%) in order to permit a one-time increase for exterior maintenance.

While there have been occasional reports that maintenance has declined in specific buildings, there have also been reports that maintenance and repairs have continued in other specific buildings. Such anecdotal reports concern

the Rent Control Board, but raise more questions than they answer. Unfortunately, there is no reliable source of data on the condition of the housing stock in Santa Monica, so it has been difficult to determine whether the incentives and penalties built into the Rent Control Law to encourage maintenance are working as well as one would hope. Because of this dilemma, the Rent Control Board in 1985 began actively seeking a research methodology that would yield reliable data on the overall condition of the housing stock.

In the meantime, an one-year pilot project, denominated the Interior Replacement Pilot Program, was implemented to permit agreements between tenants and landlords to raise the rent up to 5% in exchange for the replacement of some specified interior items. The rent increase cannot be used at the beginning of a tenancy and the program cannot be used either for repair of serious dilapidations or for additions of new amenities. These limitations are intended to prevent the program from being used in inappropriate situations, particularly where tenants lack bargaining power. At the end of the year, the pilot program will be re-evaluated to determine whether it has been successful in its goals of encouraging maintenance of the housing stock through agreements between landlords and tenants.

The pilot program was enacted at a time when litigation had greatly limited the scope of the decrease petition procedure. Just as landlords are entitled to increases when they can demonstrate increases in costs not compensated by general adjustments, tenants may obtain decreases in rent under the Rent Control Law when housing services have diminished, amenities have been removed or when substantial defects or deteriorations have gone unrepaired. In 1985, the Court of Appeals, in Sterling v. Santa Monica Rent Control Board, upheld the Board's power to grant rent decreases and overturned a lower court order that had limited the decrease petition procedure to matters unrelated to housing quality. The Court noted that the rent charged may become excessive when maintenance or services are reduced, in that the landlord would then receive a higher profit that had previously been adjudged fair; thus the power to decrease rents is important to an equitable system of rent regulation. As a result, the Rent Control Board is again accepting decrease petitions for repair problems. The 1984 amendments to the Rent Control Law also made it clear that decrease orders were effective until the Board finds that the defect has been corrected. Proposed regulations on standards for adjudicating such petitions were developed and discussed at several public hearings; revisions as a result of such hearings were underway at year's end.

DEMOGRAPHICS

Because of serious questions raised about the effect of rent control upon the diversity of the population in Santa Monica, the Rent Control Board commissioned a study in 1985 of this topic. The question posed to the researcher was, "Has the population diversity of the City of Santa Monica changed since rent control?" In December 1985, the answer came and the answer was that there were no significant changes. The report's conclusions stated:

Population is growing slightly; in-migration of Asian and Pacific Islander populations is increasing. Hispanic categories show a slight decline; and Black and White population is declining, although not in what one would call alarming numbers. Public school enrollment for Hispanics, Blacks and Whites is all down, as is overall enrollment. These figures are cyclical and in time will change again. The very slight change of population by age groups (less than three percent), and slight changes in income categories is highly significant in testing the question of the stability of the population

diversity. It appears clear that the rich diversity of the population of the City of Santa Monica has remained relatively unchanged since the pre-rent control period of 1979 to the present time.

Dr. Daniel Barber, Analysis of the Population

Diversity of the City of Santa Monica, 1979 to 1985, December 1985, page 20.

In addition, population grew by approximately 4,000 people; with the vacancy rate declining as well. It is important to recognize that median household income in Santa Monica in both 1980 and 1985 is less than that of the surrounding metropolitan area as well as the state median household income. Santa Monica median income in 1980 was \$16,604; this had grown to \$22,650 per year in 1985, an average increase of 6% per year.

