

**SANTA MONICA RENT CONTROL BOARD ADMINISTRATION MEMORANDUM**

DATE: May 20, 2003  
TO: Santa Monica Rent Control Board  
FROM: Mary Ann Yurkonis, Administrator  
FOR MEETING OF: May 22, 2003  
RE: Annual General Adjustment 2003  
Apartment Operating Cost Increases (March 2002- March 2003)

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**Summary**

The Rent Control Board is required by Section 1805(b) of the Rent Control Law to annually adjust rents, taking into account increases in utility, tax and maintenance expenses. This section of the City Charter also requires the Board to adopt a formula of general application. For most years the Board calculated the general adjustment by looking at actual increases in various expense components of the rent dollar using a formula of the "component ratio to gross rent", or what was referred to as the "pie" methodology (because each individual category of expense was assigned a portion of the total rent dollar).

An extensive review of the calculations and components used by staff in arriving at the recommended general adjustments was undertaken by Dr. Kenneth Baar and Seifel Consulting last year. The consultants' report to the Board looked at the operating cost increases from March, 2001 to March, 2002 and included an analysis of various approaches to a general adjustment. (Last year's study is attached as Exhibit 1.)

This year's recommended general adjustment looks at operating expense increases from March, 2002 through March, 2003, and includes some modifications recommended in last year's general adjustment study. Many of the components which make up the rent dollar in the general adjustment analysis are increased by the

consumer price index for all urban consumers in the Los Angeles area, which for the applicable period was 3.9%. Those components which are increased by the "CPI less shelter" were increased by 3.6%.

After calculating the increases in the various components and taking into account the formula adjustments recommended last year, staff recommends that the Board adopt a general adjustment of three percent (3%) with a cap or maximum adjustment of \$30, calculated based on the 85<sup>th</sup>-percentile of rents, and a floor or minimum adjustment of \$15 calculated on the 15<sup>th</sup>-percentile of rents. Using a dollar floor and ceiling with a percentage general adjustment ensures that owners of the lowest rent units receive sufficient dollar increases to meet increased operating expenses while preventing unnecessary rent increases to higher rent units.

Staff recommends that this matter be set for public hearing on June 12, 2003.

### **Calculation of 2003 General Adjustment**

In calculating the recommended 2003 general adjustment, staff did both an analysis using the "component ratio to gross rent" methodology and an analysis using the application of a percentage of the CPI method.

### **Component Ratio to Gross Rent Analysis**

Many of the components which make up the rent dollar are increased by either the March, 2002 to March, 2003 increase in the consumer price index (CPI) for all urban consumers in the Los Angeles area or the increase for urban consumers less shelter for the same area. The calculations of the factors which were increased by the CPI costs are not separated out this year, but instead, are included in Tables 1A and 1B with the dollar amounts and the percentage amounts. The factors increased by the CPI less shelter are the maintenance component and the insurance component. The factors increased by the full CPI of 3.9% are the self labor, cash flow and management

components. The management component is ultimately adjusted to 5% of the rent dollar after the general adjustment is calculated. The water and sewer component pursuant to Santa Monica City Ordinance is adjusted by the February to February increase for urban wage earners and clerical workers, which in the year 2002 to 2003 was also 3.9%.

The actual calculated increases for the balance of the components are set out in the Appendix. The net result of the component ratio to gross rent analysis is a general adjustment of 3.1% which staff recommends the Board round to 3.0%.

### **Percentage of CPI Analysis**

As an alternate method of analysis, staff has also calculated the general adjustment based on a percentage of the CPI as discussed in Baar's report. In arriving at what percentage of the consumer price index is necessary to provide an appropriate level of general adjustment, staff analyzed the CPI increases with the general adjustment increases authorized by the Board from 1979 to 2002. As set forth on Table 2, from 1979 to 2002 the general adjustments have been 75.34% of the full CPI increase during this more than twenty-year period. As the vast majority of those years' general adjustments were calculated looking at actual operating cost increases, the percentage of CPI that would be necessary to maintain to appropriate level of general adjustment increases would be 75%.

If we apply this methodology to the current year's CPI of 3.9%, 75% of that amount is 2.925% which would round to a 3% general adjustment.

### **Recommendation**

For the 2003 general adjustment, staff recommends the Board consider a 3% general adjustment with a ceiling or maximum rent increase calculated at the 85<sup>th</sup>-percentile of rent, which is approximately \$1,000, resulting in a ceiling of \$30; and a floor calculated on a \$500 a month rent, which is approximately the 15<sup>th</sup>-percentile of rent levels, and results in a floor of \$15.

Staff will bring the Board a staff report in the near future, recommending that it request the City Council to place an amendment to the City Charter on the ballot for the next general election to change the method for calculating the general adjustment to a percentage of the change in the CPI. This would eliminate many of the problems which have occurred over time in gathering reliable operating expense information and establishing accurate average expense levels; and would bring the Santa Monica Rent Control Board's general adjustment procedures in line with all other rent control jurisdictions in the state.

## APPENDIX

### Property Taxes

In most prior years the general adjustment calculation used a two percent (2%) increase for property taxes. Property tax increases post-Proposition 13 are generally limited to a 2% increase per year, except when properties are reassessed to market value, which usually occurs upon a sale. Larger property tax increases were used in 1989, 1992 and again in 2002.

For last year's general adjustment the consultant analyzed actual property tax information for a random sample of 272 properties. Using that information the property tax component of the rent dollar was increased substantially in last year's general adjustment. The increase of \$12.79 raised this component to \$57.53 in last year's general adjustment calculations. The adjustment was justified, because actual property tax information had not been surveyed in several years, and the consultant recommended the increase to cover average increases in property tax bills not covered by prior general adjustments. The impact of such a large increase on one component in the general adjustment was substantial last year. The increase in the property tax component in last year's general adjustment impacted the overall general adjustment by 1.96%. So, almost 2% of the general adjustment was driven last year by the property tax adjustment. (See discussion of property taxes in Baar's staff report, page 14-16.)

A major reason for the higher cost was a reassessment of properties that transferred ownership since 1995, when vacancy decontrol was enacted statewide. Higher property taxes are directly associated with higher assessed valuations, based on higher sales prices which are influenced in large part by the possibility and the actuality of potential and future substantial rent increases.

Using an average of property tax increases substantially overcompensates owners of properties which have not been sold, as those owners continue to operate with property tax bills which have not increased substantially. Recent purchasers of apartment buildings presumably took into account the higher property taxes that would be assessed on the sale of property while also calculating the higher income that could be generated from collecting market rents.

In the current year's calculation staff has again returned to using a 2% increase in the property tax component in projecting this year's recommended general adjustment.

## Water and Sewer

Water and Sewer charges are considered together in this report as they are both based on a combination of water consumption and monthly meter charges. The charges consist of water and sewer usage fees based on water consumption and water and sewer charges for apartment buildings based on the size of the water meter.

In past years, staff has collected extensive amounts of data on water consumption and water and sewer costs. Staff used the data to determine average consumption costs and meter costs. For 2001 the average cost for both the water and sewer components was estimated to be \$18.15. In Dr. Baar's report to the Board last year, the estimated cost for 2002 was set at \$18.64 based on a 2.7% increase in the CPI as set forth in City resolutions.

The resolutions direct that increases in water and sewer charges should be tied to increases in the CPI All Items for Urban Wage Earners and Clerical Workers, from February to February of each year. "(The Rent Board used a different time period [March to March] and differing indexes when using the CPI to estimate increases in other operating costs)"<sup>1</sup>. From February 2002 to February 2003, this index increased by 3.9% (from 172.8 to 179.6). As the water and sewer "rate increases are governed by the rule that they shall result in revenues increasing at the same rate as the CPI all items urban wage earners and clerical workers,"<sup>2</sup> staff is estimating that the costs for apartment owners for water and sewer services will increase by the same rate. A 3.9% increase in the average cost of \$18.64 would result in a \$0.73 cost increase per apartment per month.

	<b>2002 Average Monthly Cost per Apt. unit</b>	<b>Rate Increase 2002-2003</b>	<b>Cost Increase Apt./Month \$</b>	<b>Estimated 2003 cost</b>	<b>Pct. Increase Required</b>
<b>Water &amp; Sewer</b>	<b>\$18.64</b>	<b>3.9%</b>	<b>\$0.73</b>	<b>\$19.37</b>	<b>.11%</b>

## Refuse Collection

Refuse collection charges consist of fixed charges per apartment and collection fees dependent upon the type of refuse container and the frequency of collection. Unchanged since 1999, the fixed charges remain \$3.00 per apartment per month.

There are several types of containers and various options as to the frequency of collection. Over the years, the Rent Control Board has reviewed records of bills for a

<sup>1</sup> From Baar's staff report, page 10 (see also footnote 11 on that page).

<sup>2</sup> From Baar's staff report, page 12.

variety of apartment buildings and has calculated average expenditure levels. The “typical” configuration for type of refuse container, frequency, and cost is set forth in the table below.

A rate increase adopted in 2002 has been added to the table. The table shows the impact of the rate increase on the overall cost for a hypothetical typical apartment.

**Monthly Refuse Collection Charges Per Apartment  
(Hypothetical 10 Unit Building)**

	<u>Monthly Fee per Apartment</u>	<u>Bin Charge</u>	<u>Total Bill</u>
<b>April 1996</b>	<b>\$6.04</b>	<b>\$4.98</b>	<b>\$11.02</b>
<b>April 2000</b>	<b>3.00</b>	<b>9.30</b>	<b>12.30</b>
<b>April 2001</b>	<b>3.00</b>	<b>9.55</b>	<b>12.55</b>
<b>April 2002</b>	<b>3.00</b>	<b>10.50</b>	<b>13.50</b>
<b>April 2003</b>	<b>3.00</b>	<b>10.80<sup>3</sup></b>	<b>13.80</b>

	<b>2002 Average Monthly Cost Per Apt. Unit</b>	<b>Cost Increase 2002-2003</b>	<b>Cost Increase/Apt./Mo nth \$</b>	<b>Pct. Increase Required</b>
<b>Refuse Collection</b>	<b>\$13.50</b>	<b>\$0.30</b>	<b>\$0.30</b>	<b>0.04%</b>

The FY 2001-2002 and the FY 2002-2003 rates for each of these options are set forth in the City’s Solid Waste Division rate schedule.

**Gas - Common Areas Only**

**Average Costs**

In more than two-thirds of all apartments, the apartment owners pay for hot water heating for the entire building, while the tenant usually pays for gas for heating and cooking on an individual meter.

A 1989 report to the Board set forth average consumption rates and costs based on an analysis of 1978 gas rates. On the basis of this data, it was estimated that average monthly gas bills per unit increased from \$3.47 in 1978 to \$19.47 in 1999 and to \$32.00 in April 2001. The estimated increase to \$32.00 was due to an

<sup>3</sup> The rate for the class MSQ - one 2 yard bin picked up once weekly was increased from \$105.00 to \$108.00 per two month period. The analyses developed by staff assume two bins for such a ten unit building, resulting in a cost of \$108.00 per month.

unprecedented peak in gas rates during the time period the 2001 report was issued. By 2002 the rates had declined again. In the 2002 report to the Board, Dr. Baar reduced the estimate for 2002 back to the \$23.59 which was the average cost for gas used in the 2000 General Adjustment report based on the fact the gas rates had declined.

Also, in an effort to check the validity of the estimated costs for gas, Dr. Baar requested and received average cost data from Southern California Gas for the period April 2001 through March 2002. The data consisted of a random sample of 258 buildings with 3369 apartment units. The data indicated the average monthly cost for gas was \$9.62 per apartment unit. Dr. Baar recommended modification of the average expenditure for gas to equal \$9.62 if other data could not be developed. (See Baar's staff report, page 23.) For purposes of this report, the gas expenditure for 2002 was adjusted to equal \$16.03 (\$9.62 gas cost plus 10% tax and other incidental costs gas users are required to pay) and projected the increase in costs for 2003 using \$16.03 as the base. Gas rates have risen again in 2003 and staff is estimating the average cost of common area gas will increase to \$18.61, a 15.8% increase.

Gas Rates for Apartment Owners  
with Individually Metered Units

	Baseline*
April 2000	.61
April 2001	.94
April 2002	.60
April 2003	.70

\*Previously increases in non-baseline rates were included. However, the modified average cost of \$9.62 indicates that only the baseline rates should be applied.

	2002 Average Monthly Cost per Apt. unit	Rate Increase 2002-2003	Cost Increase Apt./Month \$	Estimated 2003 cost	Pct. Increase Required
<b>Common area average gas expense</b>	<b>\$16.08<sup>4</sup></b>	<b>15.8%</b>	<b>\$2.53</b>	<b>\$18.61<sup>5</sup></b>	<b>.38%</b>

<sup>4</sup> April 2002 Cost \$10.58 (\$16.036 therms x .5999 baseline rate = \$9.62 + 10% tax) + incidentals \$5.49 (daily service rate [30 days x .16438] + State Regulatory Fee [16.036 therms x .00076] + Low Income Discount Rate Surcharge [16.036 therms x .00186] = \$4.992 + 10% tax) = **Total cost \$16.08.**

<sup>5</sup> April 2003 Cost \$12.42 (\$16.036 therms x .7040 baseline rate = \$11.29 + 10% tax) + incidentals \$6.19 (daily service rate [30 days x .16438] + State Regulatory Fee [16.036 therms x .00199] + Low Income Discount Rate Surcharge [16.036 therms x .02781] = \$5.62 + 10% tax) = **Total cost \$18.61.**



**Table 1. Calculation of Annual General Adjustment**

**A. Dollar Amounts**

**Rent Increases Required to Cover Operating Cost Increases and Index Cash Flow**

	Estimated cost 2001 (a)	Estimated cost 2002 (b)	Estimated cost 2003 (c)	Rent Adjustment required (d)
Property Taxes	\$44.74	\$57.53	\$58.68	\$1.15
Water & Sewer	18.15	18.64	19.37	.73
Refuse	12.55	13.50	13.80	.30
Maintenance	94.79	95.83	99.28	3.45
Insurance	27.01	27.30	28.29	.98
Gas	32.00	16.08*	18.61	2.53
Electricity	14.63	10.68	10.68	0.00
Self-Labor	44.73	45.97	47.76	1.79
Debt Service	117.00	124.51	124.51	0.00
Cash Flow	214.66	221.02	229.64	8.62
Management	<u>32.64</u>	<u>33.21**</u>	<u>34.51</u>	<u>1.30</u>
Total Cost	\$652.90	\$664.28	\$685.13	\$20.85

\*The estimated cost for 2002 for Gas has been modified per Dr. Baar's recommendation stated in the 2002 General Adjustment Report. The estimated cost for Debt Service was adjusted slightly to compensate for the modification of the gas expense.

\*\* The amount of management shown here is different from the amount shown in Dr. Baar's 2002 report as management costs are always adjusted to be 5% of the total cost. The cost for Cash Flow was adjusted slightly to compensate for the management adjustment.

## B. Percentage Amounts

### Rent Increases Required to Cover Operating Cost Increases and Index Cash Flow

Operating Expense	2001 ratio to gross rent (a)	Percent increase 2001-2002 (b)	2002 ratio to gross rent (c)	Dollar adjustment 2002-2003 (d)	Percent increase 2002-2003 (e)	Percent Increase Required (c*e)
Property Taxes	0.0685	28.6%	0.0866		2.0%	0.17%
Water & Sewer	0.0278	2.7%	0.0281		3.9%	0.11%
Refuse	0.0192	7.6%	0.0203	\$0.30	2.2%	0.04%
Maintenance	0.1452	1.1%	0.1443		3.6%	0.52%
Insurance	0.0414	1.1%	0.0411		3.6%	0.15%
Gas	0.0490	-26.3%	0.0242	\$2.53	15.8%	0.38%
Electricity	0.0224	-27.0%	0.0161	\$0.00	0.0%	0.00%
Self-Labor	0.0685	2.8%	0.0692		3.9%	0.27%
Debt Service	0.1792	0.0%	0.1874		0.0%	0.00%
Cash Flow	0.3288	2.8%	0.3327		3.9%	1.30%
Management	0.0500	2.8%	0.0500		3.9%	0.20%
Total Rent Increase						3.14%

**Table 2 - GA and CPI Comparison  
1979 - 2002**

	<b>CPI Increase</b>	<b>GA Increase</b>
1979	8.8%	7.0%
1980	18.4%	6.5%
1981	9.1%	5.5%
1982	8.8%	5.5%
1983	0.3%	4.5%
1984	4.7%	4.0%
1985	4.6%	3.0%
1986	4.3%	2.5%
1987	4.0%	4.0%
1988	4.4%	3.0%
1989	4.6%	3.0%
1990	6.6%	6.0%
1991	3.9%	3.5%
1992	4.2%	3.0%
1993	3.0%	3.0%
1994	1.8%	2.0%
1995	1.4%	1.5%
1996	1.7%	1.6%
1997	1.6%	2.0%
1998	1.0%	1.0%
1999	2.2%	1.0%
2000	3.5%	3.0%
2001	3.2%	4.2%
2002	2.8%	1.75%
<b>TOTAL</b>	<b>108.9%</b>	<b>82.1%</b>
<b>GA Percentage of CPI</b>		<b>75.34%</b>