

SANTA MONICA RENT CONTROL BOARD ADMINISTRATION MEMORANDUM

DATE: May 11, 2004
TO: Santa Monica Rent Control Board
FROM: Mary Ann Yurkonis, Administrator
FOR MEETING OF: May 13, 2004
RE: Annual General Adjustment 2004
Apartment Operating Cost Increases (March 2003- March 2004)

Summary

The Annual General Adjustment for 2003-2004 is calculated 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 is also referred to as the “pie” methodology (because each individual category of expense was assigned a portion of the total rent dollar).

In 2002, Dr. Kenneth Baar prepared the 2002 General Adjustment Report for the Board. Dr. Baar analyzed various approaches to calculating the general adjustment and also completed an extensive review of the components currently used to determine the general adjustment. Dr. Baar’s report recommended some modifications be made to several of the components. The 2003 General Adjustment Report, which was based on the “component ratio to gross rent” method, incorporated many of the modifications recommended by Dr. Baar.

This year’s recommended general adjustment looks at operating expense increases from March 2003 to March 2004. A majority of the components are based on the annual increases in the consumer price index for the Los Angeles-Anaheim-Riverside area. The remaining components are based on actual rate changes or set percentages.

Recommendation

Staff recommends that the Rent Control Board set a public hearing for consideration of a 1.3% General Adjustment on June 10, 2004. Staff further recommends that the Rent Control Board adopt a ceiling or maximum adjustment of \$20. The recommended ceiling was calculated by applying the recommended 1.3% General Adjustment to the rent level at the 85th percentile of rents.

Calculation of the 2004 General Adjustment

Many of the components which make up the rent dollar are affected by increases in the Consumer Price Index in the Los Angeles Area. Following are the increases for the various indices used in this year's general adjustment report:

<u>March 2003 – March 2004</u> :	CPI for All Urban Consumers – 1.8% increase
	CPI for All Urban Consumers – All items less shelter - .2%
<u>February 2003 – February 2004</u>	CPI for Urban Wage Earners and Clerical Workers - 2.1%

The components to be increased by the CPI “less shelter” (.2%) are maintenance and insurance. Self labor, cash flow and management costs are adjusted by the full CPI of 1.8%. (Management is ultimately adjusted to 5% of the rent dollar after the general adjustment is calculated.) The water and sewer component is adjusted by the February-February increase for CPI for urban wage earners and clerical workers pursuant to a Santa Monica City Ordinance. The remaining components, including property taxes, refuse, gas and electricity are based on either established set increases or actual changes in rates. Details for each component are set forth below. The net result of the component ratio to gross rent analysis is a general adjustment calculation of 1.26% which staff recommends the Board round to 1.3%.

Component Calculations

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. Staff most often uses the 2% limit in calculating the property tax component of the rent dollar. Larger property tax increases were used in 1989, 1992 and again in 2002. In 2002 the increase was 28.6% and was based on Dr. Baar's analysis of property tax bills for a random sample of 272 properties. The significant increase was related to a reassessment of properties that transferred ownership since 1995, when vacancy decontrol was enacted statewide. To use an average of property tax increases every year would substantially over-compensate owners of properties which have not been sold, as those owners continue to operate with property tax bills which increase by no more than 2%.

After the significant increase in this component in 2002, staff used a 2% increase in last year's general adjustment calculation. Staff believes it is appropriate to again use the 2% standard increase in the property tax component for projecting this year's general adjustment. The table below reflects the 2% increase projected for 2004.

Average Monthly Property Tax Bill	
1978	\$19.20
2001	44.74
2002	57.53
2003	58.68
2004	59.85

	2003 Average Monthly Property Tax Bill	Rate Increase 2003-2004	Cost Increase Apt./Month \$	Estimated 2004 cost
Property Tax	\$58.68	2%	\$1.17	\$59.85

Water and Sewer

Water and Sewer charges are considered together in this report as the costs for both are made up of usage fees related to water consumption and meter charges based on the size of the water meter. Two factors influence the average cost of water/sewer costs used in the calculation of the annual general adjustment report.

The first factor is the actual water and sewer rates, while the second is related to water consumption. Pursuant to a City resolution ¹ increases in water and sewer rates are tied to increases in the CPI for all items for Urban Wage Earners and Clerical Workers from February to February of each year.

¹ Resolution No. 9409 (CCS) (A Resolution of the City Council...Establishing an Annual Consumer Price Index Increase on Water Rates and Fees), Sec. 4 (June 22, 1999).

Since water consumption is directly related to actual water and sewer costs, staff has monitored consumption over the years. As of 1997 staff has been tracking water consumption rates and costs of water/sewer and refuse bills on the same two sets of randomly selected properties. (One set was tracked starting in 1992.) The information compiled from this research has led to some modifications over the years to the average consumption rate (measured in HCF – hundred cubic feet). The latest modification in the year 2000 adjusted the average consumption rate to 4.6 HCF. Staff has used 4.6 HCF as the average consumption rate since that time.

For purposes of this report, staff reviewed the water consumption rates and costs of water/sewer and refuse bills for the two sets of properties. Currently, the two sets include 56 and 74 properties. The average HCF for the first selection is somewhat higher than the average at 5.30 HCF, while the second selection is a little lower, at 4.4 HCF. It is possible that the first selection is higher due to fewer addresses in the selection. The combined average of both the selections, however, is 4.61. Staff believes the results of the survey support the continued use of 4.6 HCF as the average consumption rate. However, it is important to continue monitoring water consumption so any changes can be reflected in future general adjustment reports.

Although it is not necessary to make any adjustments to the 2003 average cost for water and sewer charges related to water consumption, the rates themselves will be increased in July by the CPI increase of 2.1% (February 2003 – February 2004). The table below reflects the projected increase:

	2003 Average Monthly Cost per Apt. unit	CPI all items Urban Wage Earners & Clerical Workers Pct. Increase	Cost Increase Apt./Month \$	Estimated 2004 cost
Average water/sewer expense	\$19.37	2.1%	\$0.41	\$19.78

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.

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 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.

Unchanged since 1999, the fixed charges remain \$3.00 per apartment per month. An increase in collection rates was adopted in 2003². 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>
April 2001	3.00	9.55	12.55
April 2002	3.00	10.50	13.50
April 2003	3.00	10.80	13.80
April 2004	3.00	11.20	14.20

The difference between the 2003 total bill estimated at \$13.80 and the projected cost of \$14.20 for 2004 reflects at 2.9% increase.

	2003 Average Monthly Cost Per Apt. Unit	Percent Cost Increase 2003-2004	Cost Increase Apt./Month \$	Estimated 2004 cost
Refuse Collection	\$13.80	2.9%	\$0.40	\$14.20

Gas - Common Areas Only

Average Costs

In more than two-thirds of all apartments, the apartment owners pay for hot water heating through master metered service, while the tenant usually pays for gas heat for the unit on an individual meter.

The gas component was modified per Dr. Baar’s recommendation in the 2002 General Adjustment Report. The modification was based on the results of a survey of 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 and indicated the average monthly cost for gas was \$9.62 per apartment unit. In the 2003 General Adjustment Report, staff modified the gas expenditure for 2002 to equal \$16.03 (\$9.62 gas cost plus 10% tax and other incidental costs gas users are required to pay) and projected the costs for 2003 using \$16.03 as the base with an average use of 16.036 therms. Gas rates rose in 2003 to \$0.7040 per therm and staff estimated the average cost of common area gas for 2003 to be \$18.61. As of April 1, 2004, gas rates have risen again to \$0.75348 per therm. Staff is

² The rate for the class MSQ - one 2 yard bin picked up once weekly was increased from \$108.00 to \$112.00 per two month period. The analyses developed by staff assume two bins for such a ten unit building, resulting in a cost of \$112.00 per month or \$11.20 per unit/per month.

estimating the average cost of common area gas will increase to \$19.38 based on the increase in rates. The rate increase has the net effect of a 4.12% increase in the overall cost for this component.

Gas Rates for Apartment Owners with Individually Metered Units

	Baseline*
April 2002	.60
April 2003	.70
April 2004	.75

*Previously staff included increases in non-baseline rates. However, data obtained by Southern California Gas for the 2001-2002 General Adjustment report indicates that only the baseline rates should be considered at this time.

	2003 Average Monthly Cost per Apt. unit	Rate Increase 2003-2004	Cost Increase Apt./Month \$	Estimated 2004 cost
Common area average gas expense	\$18.61³	4.12%	\$0.77	\$19.38⁴

Electricity- Common Areas Only

Average Costs

Based on information from Southern California Edison, from June 1996 through 2000, there had been a rate freeze in effect. In 2001, The Public Utilities Commission authorized a significant increase in rates. By 2002, that exceptional rate increase had been rolled back. Per Dr. Baar's report for 2001-2002, the average cost for electricity used in the general adjustment calculation was also rolled back. The report for 2002-2003 projected no change to this component and is currently set at \$10.68.

In preparation for this report, staff again reviewed information from Southern California Edison to determine if any changes were necessary to the electricity component. Staff found that between August 1, 2003 and February 1, 2004 there have been five distinct changes in the rates in that six month period. The second change in September 2003, reflects a change in the entire billing structure. In addition to the baseline and non-baseline rate tiers, there is now a separate "generation" charge for each rate tier. The generation charge is comprised of two categories - the cost of energy obtained from Southern California Edison and the cost of energy obtained from the Department of Water Resources.

³ 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**

⁴ April 2004 Cost \$13.29 (16.036 therms x .75348 baseline rate = \$12.08 + 10% tax) + incidentals \$6.09 (daily service rate [30 days x .16438] + State Regulatory Fee [16.036 therms x .0076] + Low Income Discount Rate Surcharge [16.036 therms x .0370] = \$5.54 + 10% tax) = **Total cost \$19.38.**

Staff analyzed each of the five rate changes using the baseline and 1st tier of non-baseline rates⁵ and found that three of the five rate changes result in approximately the same cost per kilowatt, while the other two changes reflect an increase (both increases result in approximately the same cost per kilowatt). The most current rate increase reflects a per/kilowatt/cost that is slightly less than the rate used in the average electricity cost component for 2003 of \$10.68. It is difficult to accurately project a change in the electricity costs when there have been so many changes in the last months. It is unclear at this time whether electricity costs will rise, fall or remain somewhat constant. As the most recent rate change, as well as two of the other rate changes, results in a cost close to the figure currently being used by staff, staff is not projecting any increase in this component. If there is an increase in rates it can be reflected in next year's general adjustment. It is not clear at this time that actual electric costs have increased in the last year, so no increase in this component is included in this year's general adjustment calculations.

	2003 Average Monthly Cost per Apt. unit	Rate Increase 2003-2004	Cost Increase Apt./Month \$	Estimated 2004 cost
Common area average electricity expense	\$10.68	0%	\$0.00	\$10.68

Maintenance and Other Operating Expenses

Information for this expenditure specific to Santa Monica is not available. For the 2001-2002 report, Dr. Baar obtained data from Apartment Industry Sources for the Los Angeles area for the year 2000. The data indicated the ratios for maintenance and other expenses ranged from \$68 - \$126. Although this information was not specific to Santa Monica, the monthly cost used by the Board for this component falls within that range. As specific information is not available, the Board adjusts this category by the change in the Consumer Price Index, less shelter. The March 2003 – March 2004 percent increase for this index was .2%. The effect of this increase on the maintenance component is shown below:

	2003 Average Monthly Cost Per Apt. Unit	CPI all items less shelter Pct. Increase	Cost Increase Apt./Month \$	Estimated 2004 Cost
Maintenance	\$99.28	.2%	\$0.20	\$99.48

Insurance

In 1997, the Board commissioned Thomas D. Stringer of Stringer Appraisals to prepare a report on insurance costs. Based on that report and other information gathered by the Board, staff separated the insurance component from the maintenance component and set the average monthly cost per apartment at \$23.96. The component was again adjusted in 1998 based on a subsequent report by Mr. Stringer. Since that time, the Board has used the change in the Consumer Price Index, less shelter to calculate the annual increase for this

⁵ Staff has used 1638 kWh as the average consumption level for electricity in a 6 unit building. Of the 1638 kWh, 1140 hours are calculated at baseline, and 498 hours at non-baseline.

component. The March 2003 – March 2004 percent increase for this index was .2%. The effect of this increase on the insurance component is shown below:

	2003 Average Monthly Cost Per Apt. Unit	CPI all items less shelter Pct. Increase	Cost Increase Apt./Month \$	Estimated 2004 Cost
Insurance	\$28.29	.2%	\$0.06	\$28.35

Self Labor

The Board uses the change in the Consumer Price Index for All Urban Consumers to adjust the self-labor component for purposes of calculating the annual general adjustment. The March 2003 – March 2004 percent increase for this index was 1.8%. The effect of this increase on the self labor component is shown below:

	2003 Average Monthly Cost Per Apt. Unit	CPI all items Pct. Increase	Cost Increase Apt./Month \$	Estimated 2004 Cost
Self Labor	\$47.76	1.8%	\$0.86	\$48.62

Cash Flow Adjustment

The Board uses the change in the Consumer Price Index for All Urban Consumers to adjust the cash flow component for purposes of calculating the annual general adjustment. The March 2003 – March 2004 percent increase for this index was 1.8%. The effect of this increase on the cash flow component is shown below:

	2003 Average Monthly Cost Per Apt. Unit	CPI all items Pct. Increase	Cost Increase Apt./Month \$	Estimated 2004 cost
Cash Flow	\$229.01	1.8%	\$4.12	\$233.13

Management

Management costs are fixed at 5% of gross rent pursuant to Rent Board Regulation 4101(c)(1). For purposes of calculating the annual general adjustment, the Board uses the change in the Consumer Price Index for All Urban Consumers. The March 2003 – March 2004 percent increase for this index was 1.8%. The effect of this increase on the management component is shown below:

	2003 Average Monthly Cost Per Apt. Unit	CPI all items Pct. Increase	Cost Increase Apt./Month \$	Estimated 2004 Cost
Management	\$34.21	1.8%	\$0.62	\$34.83

Calculation of Annual General Adjustment

A. Dollar Amounts

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

	Estimated cost 2003* (a)	Estimated cost 2004 (b)	Rent Adjustment required (b-a)
Property Taxes	\$58.68	\$59.85	\$1.17
Water & Sewer	19.37	19.78	.41
Refuse	13.80	14.20	.40
Gas	18.61	19.38	.77
Electricity	10.68	10.68	.00
Maintenance	99.28	99.48	.20
Insurance	28.29	28.35	.06
Self-Labor	47.76	48.62	.86
Debt Service	124.51	124.51	.00
Cash Flow	229.01	233.13	4.12
Management	<u>34.21</u>	<u>34.83</u>	<u>.62</u>
Total Cost	\$684.20	\$692.81	\$8.61

* The amounts have been adjusted to reflect the 3% general adjustment authorized by the Board in 2003.

B. Percentage Amounts

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

	2003 ratio to gross rent (a)	Percent increase 2003-2004 (b)	Percent Increase Required (a*b)
Operating Expense			
Property Taxes	0.0858	2.0%	0.17%
Water & Sewer	0.0283	2.1%	0.06%
Refuse	0.0202	2.9%	0.06%
Gas	0.0272	4.12%	0.11%
Electricity	0.0156	0.0%	0.00%
Maintenance	0.1451	0.2%	0.03%
Insurance	0.0413	0.2%	0.01%
Self-Labor	0.0698	1.8%	0.13%
Debt Service	0.1820	0.0%	0.00%
Cash Flow	0.3347	1.8%	0.60%
Management	0.0500	1.8%	0.09%
		Total Rent Increase	1.26%

C. Percentage and Dollar Amounts - Rounded to 1.3%

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

	2003 ratio to gross rent (a)	Percent increase 2003-2004 (b)	Percent Increase Required (a*b)	Estimated cost 2004 (c)	Rent Adjustment required (d)
Operating Expense					
Property Taxes	0.0858	2.0%	0.17%	\$59.85	\$1.17
Water & Sewer	0.0283	2.1%	0.06%	19.78	.41
Refuse	0.0202	2.9%	0.06%	14.20	.40
Gas	0.0272	4.12%	0.11%	19.38	.77
Electricity	0.0156	0.0%	0.00%	10.68	.00
Maintenance	0.1451	0.2%	0.03%	99.48	.20
Insurance	0.0413	0.2%	0.01%	28.35	.06
Self-Labor	0.0698	1.8%	0.13%	48.62	.86
Debt Service	0.1820	0.0%	0.00%	124.51	.00
Cash Flow	0.3347	1.8%	0.67%	233.59	4.58
Management	0.0500	1.8%	0.06%	<u>34.66</u>	<u>.45</u>
		Total Rent Increase	1.3%	\$693.10	\$8.90