

RESOLUTION NO. RAC 09-2011

**A RESOLUTION OF THE RENT ADJUSTMENT
COMMISSION OF THE CITY OF THOUSAND OAKS
APPROVING A JUST AND REASONABLE RETURN
RENT INCREASE FOR THE RANCH MOBILE HOME
PARK.**

WHEREAS, on June 16, 2010, an application was filed on behalf of the Ranch Mobile Home Park ("Park") by the owner AVMGH Five, Limited ("Park Owner") under §5-25.06(b) of the Mobile Home Rent Stabilization Ordinance ("Ordinance") requesting a rent increase of \$587.45 per space, per month; and

WHEREAS, on September 30, 2010, City staff deemed the application complete; and

WHEREAS, on October 8, 2010, City staff mailed notice to each mobile home owner or current resident of the Park that (1) a Just and Reasonable application had been filed, (2) the amount of the requested rent adjustment, (3) the date (December 6, 2010), time and place of the public hearing, and (4) where information regarding the application could be obtained; and

WHEREAS, on December 6, 2010, a public hearing was held before the Thousand Oaks Rent Adjustment Commission to consider the application. Evidence and testimony was submitted by City staff. The hearing was continued to January 24, 2011, where the applicant, legal representatives of the tenants of the Park, and the public provided additional evidence and testimony. The hearing was again continued to February 7, 2011 where additional public testimony, evidence and testimony was received. The public hearing was closed on February 7, 2011.

NOW, THEREFORE, BE IT RESOLVED by the Thousand Oaks Rent Adjustment Commission ("Commission") as follows:

SECTION 1. Findings.

Based upon substantial evidence taken from testimony received at the hearing, both oral and written, the Commission makes the following findings:

A. Background regarding Ranch Mobile Home Park

1. The current average monthly space rent in the Park is approximately \$133. In addition to paying space rents, the tenants pay for gas, electricity, and sewer, but not water and trash expenses. The average total utility cost for the residents of the Park is \$69.25 per month per space.

2. In 1974, the Park was entitled to allow the construction of a 74-unit mobile home park. Conditions of that approval required that the tenants be lower-income seniors and that rental rates be established by the City.

3. In 1976, the Council approved a formula for calculating rents based on an 11.5% rate of return on investment. In 1977 the current Park Owner purchased the Park. Average initial rental rates were set at \$119 per space per month based on an initial investment of \$500,000 with a rate of return of 11.5%. At the time initial rental rates were set, the City did not have a Rent Stabilization Ordinance.

4. In 1984, Council passed Resolution 84-037 authorizing a general rent increase of 7% for the Park, but capping future increases to 4% based on a revised formula. In 2001, Council approved a 4% increase under the formula established in Resolution 84-037. These rent increases were not processed under the Ordinance or the Ordinance as it existed in 1984. Prior to this application, the Park Owner has not sought any other rent increases.

5. Based on the unique history of the Park, and as confirmed by the appraisal of James Brabant dated November 19, 2010, (Staff Report, Attachment #6), the Commission finds that the rental rates at the Park have never been established at market rate at any time prior or during the Park's history, including prior to the initial adoption of the Ordinance in 1980.

B. Expert Analysis of Ranch Mobile Home Park Rent Increase Application.

The City retained an expert on fair return issues, Dr. Kenneth Baar, to prepare a fair return analysis (Staff Report, Attachment #5 at pages 96-154). Based on Dr. Baar's resume (Staff Report, pages 146-154), the Commission finds that Dr. Baar has the requisite expertise to render opinions regarding what rents in this case provide a fair return to the Park Owner.

C. Provisions in the Ordinance and Regulations Governing Rent Increases

1. The Commission only has jurisdiction to consider "Just and Reasonable Return" rent adjustment requests under the Ordinance and not under Resolution 84-037, or any condition of entitlement of the Park.

2. The Commission has the legal authority to consider the Park Owner's application for a rent adjustment based on the "Just and Reasonable Return" standard under the Ordinance. The principal purpose of this provision is

to provide rent adjustments which meet constitutional fair return standards when automatic rental increases fail to provide a fair return.

3. The Commission has promulgated and adopted detailed guidelines ("Guidelines") pursuant to the Ordinance implementing the "Just and Reasonable Return" standard. These Guidelines are contained in resolutions RAC-2 and RAC-5.

4. The Guidelines recommend the use of a maintenance of net operating income standard ("MNOI standard") to evaluate applications seeking "just and reasonable return." However, the Guidelines allow the Commission to consider other approaches and methodologies.

5. The Park Owner has requested a rent adjustment based on the MNOI standard.

6. Despite the fact that prior rent increases for the Park have been based on a Rate of Return standard outside of the parameters of the Ordinance, the Commission finds that the use of that standard under the Ordinance and Guidelines in this case would be precedent setting. The Commission further finds that the Rate of Return standard is circular in that park owners could set the amount of investment, and therefore determine the rent levels. This method would also unjustly favor recent purchasers of mobile home parks, while long-term owners, who typically have a substantially lower initial investment by current standards, would have lower returns. For these reasons, and those listed in Dr. Baar's report dated November 30, 2010 (Staff Report, Attachment #5 at pages 135-138), the Commission rejects the use of the Rate of Return standard for this application.

7. The Commission finds that the MNOI standard is the most appropriate methodology for considering the Park Owner's application because it meets the constitutional fair return standard and is the preferred method in the Guidelines.

D. Analysis under the MNOI standard.

In order to perform a MNOI analysis a number of determinations must be made, including:

- The applicable base year
- The amount of the base year rent
- The amount of the base year operating expenses
- The inflation adjustment factor applied to the base year net operating income in order to determine what net operating income is a fair net operating income in the current year

1. Designation of the Base Year.

a. The Guidelines state that the base year shall be 1979 when the financial information for that year is available, and when 1979 information is not available the first year for which a park owner has financial records may be used as a base year. (RAC-2, Secs. 3 and 4.)

b. The Guidelines also vest in the Commission the discretion to consider a base year other than 1979 for good cause. (RAC-5, Sec. 3.07)

c. The Park Owner was unable to provide data on actual operating expenses and net operating income for the base year (1979). The owner did provide aggregate expense data from 1982 (from a prior application in 1984) and complete segregated expense data from 1999 (from a prior application in 2000).

d. The Commission is persuaded that as a policy the Guidelines should be adhered to the extent such adherence provides results that are in keeping with the intent of the Ordinance and Guidelines. Therefore, because of the lack of expense data, 1979 should not be the base year.

e. Although 1999 is the first year with complete segregated expense data, because of the necessity of a "Vega" adjustment, it would be difficult to determine what market rent, as opposed to comparable rent, would be in 1999.

f. The Commission concludes that there is good cause to use 1982 as the base year since the Guidelines stipulate that base year should have actual income and expense data for purposes of comparison. Despite the lack of segregated expense data for this year, large expense items, excluding management and administrative expenses which were not recorded expenses in 1982, appear to have increased at the rate of inflation as compared to 2009 (Staff Report, Attachment #5 at pages 118). Therefore, the Commission finds that aggregate expense data from 1982 is sufficient for comparison with the current year (2009).

2. Base Year Rental Income

a. The Commission recognizes the case of Vega v. City of West Hollywood 223 Cal.App.3d 1342 (1990) which stipulates that adjustments to base year rents are constitutionally required for special circumstances in which the base rent cannot reasonably be deemed to reflect general market conditions.

b. The Commission finds that the actual average rent in the Park in 1982 was \$119. The Commission further finds that the initial rents established for the Park in 1977 (\$119) were not set by general market conditions, but by conditions of approval which limited rents based on a rate of

return of the initial investment of 11.5%. The initial average rent remained unchanged until 1984. Based on the appraisal prepared by James Brabant, dated November 19, 2010, the average market rent for the Park in 1979 was \$150, and in 1982 projected comparable rent, as calculated by Dr. Baar, would have been \$178.50 (Staff Report, Attachment #5 at page 122)

c. The Commission concludes that the 1982 base rent should be adjusted upward under the theory in "Vega" from the actual average rent of \$119 per space per month to \$178.50 per space per month.

3. Base Year Operating Expenses

a. The Guidelines provide that management and administrative expenses "must be calculated for both the base year and the current year at the same percentage of actual income" and may not exceed 8% of the actual rental income. (RAC-2, Sec. 2.11)

b. Because the rents in this Park barely increased between 1982 and 2009, and an increase of management and administrative expenses during this period would have been inevitable, it is not reasonable to project management and administrative expenses as the same percentage of income in the base year (1982) and current year (2009). It would be reasonable to project that administrative and management expenses increased by the CPI.

b. In this case, the Park Owner reported that 1982 total expenses were \$34,424, and in 2009 total expenses were \$97,452. Therefore, operating expenses increased by 183% between 1982 and 2009 compared to the 129.4% increase in the CPI. (Staff Report, Attachment #5 at page 118.).

c. The Park Owner admits that management tasks were performed by the Park Owner until 2006, when off-site management was employed. (Staff Report, Attachment #5 at pg 118, fn. 53.)

d. Consequently, the transfer from owner management to management compensated by the owner is a change in how the cost is covered from an accounting perspective, and not a cost increase equal to the current cost.

e. Management and administrative expenses should be imputed to the base year in order to avoid exceptionally low expenses in the base year, which would result in an unjustified overstatement of the NOI for the base year.

f. Because of the gap in available information, 1982 operating expenses should be increased to a level which limits the rate of operating expense increases from 1982 to 2009 at the rate of increase of the CPI. Under

this approach, the Commission finds that operating expenses should be adjusted from \$34,424 to \$42,555 in 1982. The basis for this computation is set forth in Dr. Baar's report (Staff Report, Attachment #5 at pg. 118), which is adopted and incorporated into this resolution by reference.

4. An Inflation Adjustment of Base Period Net Operating Income

a. Under the Section 5-25.06(b)(1) of the Ordinance, the Commission has the authority to grant individual park rent adjustments if the rent "otherwise permitted" does not provide for a just and reasonable rent.

b. California courts have upheld maintenance of net operating income standards which provide for indexing net operating income at 40% and 50% of the percentage increase in the CPI since the base year.

c. The Guidelines do not provide a rate of indexing for the MNOI standard.

d. The Commission adopts the findings in Dr. Baar's report (Staff Report, Attachment #5 at pages 123-131) that the returns from a park investment may be attractive when net operating income increases at less than the full rate of increase in the CPI. Growth in net operating income provides the Park Owner with appreciation in valuation as well growth in income in an investment that typically is low-risk with a steady and consistent income stream.

e. The Commission concludes that indexing the net operating income by 50% of the percentage increase in the CPI provides a "just and reasonable return" to the Park Owner.

SECTION 2. Authorized Rent Increase.

A. The Park Owner is entitled to a rent increase of \$191.95 per space per month in order to obtain a just and reasonable return based on the findings in SECTION 1 above. The basis for this calculation is set forth in 1982 Base Year Table of Dr. Baar's report (Staff Report, Attachment #5 at page 133) and in the table below.

MNOI Fair Return Calculation

	Base Year (1982)	Current Year (2009)
Rental Income (excluding reimbursed utilities) With Base Year Rent Adjustment pursuant to MNOI analysis	\$158,508	\$117,920
Operating Expenses adjusted pursuant to MNOI analysis	\$42,555	\$97,452
Net Operating Income	\$115,953	\$20,468
Fair Net Operating Income (50% CPI Index) (64.7% Increase over Base Year NOI)		\$190,917
Rent Increase Required (Fair NOI – Actual Current Year NOI)		\$170,449
Rent Increase Required Per Space Per Month (Park wide Rent Increase/(74 spaces x 12 months))		\$191.95

B. The Commission finds that the authorized increase of \$191.95 per space per month is equivalent to a 144% increase over the current rents of \$133 per space per month. Because of the magnitude of this rent increase, it would place an unreasonable burden on the tenants of the Park if it were implemented at one time. Therefore, this increase in rents shall be phased over a 7-year period (\$27.42 per year per month). This phase-in requirement shall only apply to spaces that are occupied at the time the initial rent increase becomes effective under subparagraph D.

C. In addition, to compensate the Park Owner for the delay in implementing the full rent increase over a seven-year period, the Park Owner shall also be entitled to a 4% annual return on the delayed rent increases which shall be amortized over the 7-year phase-in period, and in addition to the \$27.42 per space per month annual increase. The Commission finds that a 4% annual return represents an appropriate rate of return comparable to other investments of similar term and risk in the current interest rate environment. In addition to the amount in Section B above, Park Owner is entitled to add the following Interest on Deferred Rent to the rent per space per month:

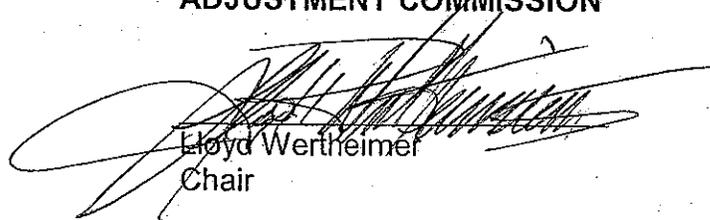
Year	Interest on Deferred Rent	Total Rent Increase
Initial increase	\$6.58 - (\$164.53x4%)	\$34.00
Second increase	\$5.48 - (\$137.11x4%)	\$32.90
Third increase	\$4.39 - (\$109.69x4%)	\$31.81
Fourth increase	\$3.29 - (\$82.27x4%)	\$30.71
Fifth increase	\$2.19 - (\$54.85x4%)	\$29.61

Sixth increase	\$1.10- (\$27.43x4%)	\$28.52
Seventh increase	\$0.00	\$27.42

D. The date of initial increase shall be 90 days from the date of formal notice of such increase is provided to the tenants, and the date of each subsequent increase shall not be sooner than 365 days from the date of prior increase.

PASSED AND ADOPTED this 7th day of February, 2011.

**THOUSAND OAKS RENT
ADJUSTMENT COMMISSION**

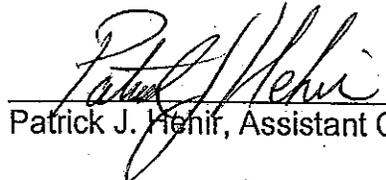


Lloyd Wertheimer
Chair

ATTEST:


Recording Secretary

APPROVED AS TO FORM:


Patrick J. Henif, Assistant City Attorney