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7

8 BEFORE THE CITY COUNCIL
9 OF THE CITY OF THOUSAND OAKS
10

11 AVMGH, Ltd., a California Limited
Partnership [Owner of Thunderbird Oaks
12 Mobilehome Park],

13 Applicant.
14

CASE NO. RAA-2010-01

15 AVMGH BRIEF ON APPEAL FROM
16 RENT ADJUSTMENT COMMISSION
17 DECISION

Date: April 26, 2011

Time: 6:00 p.m.

Place: Scherr Forum Theatre
City of Thousand Oaks
2100 Thousand Oaks Blvd.
Thousand Oaks, CA

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1 **I. INTRODUCTION**

2 AVMGH Ltd, the owner of Thunderbird Oaks Mobilehome Park requests a monthly
3 space rent increase of \$260.62 per month in order to obtain a constitutionally required “just
4 and reasonable” return on its property. The City Code requires that the City’s Rent
5 Adjustment Commission (“Commission”) make a determination of the amount of space rent
6 necessary to obtain a “just and reasonable” return on mobilehome property. (City Code, § 5-
7 25.06 (b)) The Commission determined that the Park Owner was entitled to a monthly space
8 rent increase of only \$65.00 per month, to be phased in at equal amounts of \$32.50 over a
9 period of two years.

10 The difference between the Park Owner’s request and the Commission’s
11 determination is the result of five incorrect legal conclusions and/or findings adopted by the
12 Commission. This appeal disputes those five incorrect legal conclusions and/or findings:

- 13 1. That 1986 rather than 1979 should be used as the “base year”;
- 14 2. That base year rents should be determined by a “price level adjustment” rather
15 than by fair market value;
- 16 3. That base year expenses should be imputed at the current year level of
17 expenses (as adjusted for inflation);
- 18 4. That the base year net operating income should be adjusted for only 50% of
19 inflation for purposes of comparison with the current year net operating
20 income in order to determine the amount of the applicable rent increase;
- 21 5. That the applicable rent increase may be phased in over a period of years rather
22 than immediately.

23 The Park Owner, AVMGH Ltd., contends that the Commission abused its discretion
24 by failing to follow the law in adopting those five legal conclusions and/or findings, and
25 further contends that those findings are not supported by the evidence. The City Council
26 must review those legal conclusions and/or findings under the de novo standard of review,
27 without giving any presumptive weight to the Commission’s determinations. (See *LT-WR,*
28 *LLC v. California Coastal Commission* (2007) 152 Cal.App.4th 770, 780)

1 **II. THE MNOI FORMULA MUST BE CORRECTLY APPLIED IN ORDER TO**
2 **SATISFY THE CONSTITUTIONAL REQUIREMENT FOR A “JUST AND**
3 **REASONABLE RETURN”**

4 The Park Owner agrees with the Commission that the Maintenance of Net Operating
5 Income (“MNOI”) formula adopted by the City should be applied, but contends that the
6 Commission did not properly apply the MNOI formula in the present case, contrary to the
7 City’s regulations and California case law. In order to understand the significance of the
8 appeal, it is important to understand the constitutional principle that is being applied through
9 use of the MNOI formula and why that formula must be strictly followed.

10 Price controls on rent are within the City’s police power only if they are reasonably
11 calculated both to eliminate excessive rents and they provide the owner with a “just and
12 reasonable” return on its property. (See *Concord Communities v. City of Concord* (2001) 91
13 Cal.App.4th 1407, 1414) To be “just and reasonable,” a rate of return must be high enough
14 to encourage good management, including adequate maintenance of services, to furnish a
15 reward for efficiency, to discourage the flight of capital from the rental housing market, and
16 to enable operators to maintain and support their credit. (*Id.* at 1415)

17 In determining a “just and reasonable” rate of return, no particular formula or
18 combination of formulas is mandated. (*T.G. Oceanside, L.P. v. City of Oceanside* (2007)
19 156 Cal.App.4th 1355, 1372) One formula that courts have accepted is the “maintenance of
20 net operating income” (“MNOI”) formula. (*Id.* at 1375-1376 [court allowed evidentiary
21 presumption that formula is valid])

22 The MNOI formula presumes that the landlord’s net operating income at the time rent
23 control began provided a just and reasonable return. (See *Kavanau v. Santa Monica Rent*
24 *Control Bd.* (1997) 16 Cal.4th 761, 768) In order to maintain this net operating income at a
25 constant level, the law permits rent increases that will enable the landlord to recoup increases
26 in ongoing operating expenses, including those caused by inflation. (*Id.* at 769)

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1 Of course, if the law holds net operating income constant, inflation will erode the real
2 value of that income. Thus, maintenance of net operating income formulas require inflation
3 adjustments. (See *Kavanau v. Santa Monica Rent Control Bd.*, *supra*, 16 Cal.4th at 769)

4 In accordance with constitutional limits on the City's police power, the City's
5 Mobilehome Rent Stabilization Ordinance No. 1254-NS (City Code, Title 5, Chapter 25)
6 provides that the City's Rent Adjustment Commission must adopt a discretionary rent
7 increase if it finds that such increase is in keeping with the purposes of the Ordinance and if
8 the permitted automatic adjustments to rent do not provide a just and reasonable rent under
9 guidelines established by the Commission. (City Code § 5-25.06 (b))

10 The Commission Guidelines establish a MNOI formula for determining whether a
11 mobilehome park owner is entitled to discretionary rent increases.

12 The Commission presumes that the net operating income
13 received up to April, 1980 provided landlords with a Just and
14 Reasonable Return on their rental units, unless there is clear and
15 convincing evidence to the contrary. In most cases, the
16 automatic increases allowed by the Ordinance and the property
17 tax savings resulting from Proposition 13 provide sufficient
18 additional operating income to landlords to maintain the same net
19 operating income they experienced in 1979. However, in some
20 cases landlords may have incurred reasonable operating expenses
21 which exceed the rent increases allowed by the Ordinance and
22 the tax savings resulting from Proposition 13. Therefore,
23 landlords who have had such reasonable increased operating
24 expenses should be able to maintain the same level of net
25 operating income as they experienced in 1979 by requesting a
26 rent adjustment pursuant to these guidelines. (Rent Adjustment
27 Commission Resolution No. ["RAC"]-2 Establishing Guidelines
28 in Order to Determine a "Just and Reasonable Return" § 1.03)

21 The MNOI formula is simple. It presumes that the Park's pre-rent control net
22 operating income provided a just and reasonable return on investment. Thus, in order to
23 determine whether there are increased costs of operation in the current year net operating
24 income that justify a rent increase, the current year net operating income is compared with
25 the inflation adjusted base year net operating income. Of course, if the Park Owner can
26 demonstrate that Base Year rents were below market value, then base year net operating
27 income must be adjusted accordingly before accounting for inflation.
28

1 **III. THE COMMISSION CONCLUSION/FINDING THAT 1986 SHOULD BE THE**
2 **BASE YEAR IS CONTRARY TO THE LAW AND THE EVIDENCE.**

3 **A. 1979 Must Be the Base Year As A Matter of Law**

4 The guiding principle for determining the base year under the MNOI formula is that
5 the base year must be prior to the imposition of rent control or otherwise based on pre-rent
6 control fair market assumptions. “In general, the maintenance of net operating income
7 formula is based on pre-rent control, fair market assumptions.” (*MHC Operating Limited*
8 *Partnership v. City of San Jose* (2003) 106 Cal.App.4th 204, 223) A City may use another
9 base year if expressly set forth in its ordinance or regulations, but the use of another base
10 year must be justified by principles of “pre rent control fair market assumptions.” (*Id.*)

11 The City Ordinance and Commission Guidelines clearly require that the period from
12 June 1979 to May 1980 must be used as the base year:

13 “Maximum rent” is the highest legal monthly rate of rent
14 which was in effect for the rental space during any portion of the
15 month of June 1980. If a rental space is not rented during said
16 month, then it shall be the highest legal monthly rate of the rent
17 in effect between June 1, 1979 and May 31, 1980. (City Code,
18 Section 5-25.02 (k))

19 The Commission presumes that the net operating income
20 received up to April, 1980 provided landlords with a Just and
21 Reasonable Return on their rental units, unless there is clear and
22 convincing evidence to the contrary. (City Rent Adjustment
23 Commission Resolution No. [“RAC”]-2 Establishing Guidelines
24 in Order to Determine a “Just and Reasonable Return” § 1.03)

25 The Commission contends that 1979 cannot be used as a base year because there is no
26 actual expense data for 1979, but instead imputed 1979 expenses based on backwards
27 inflation adjustments from 1986 expense data. Contrary to the Commission’s contention,
28 California courts have readily accepted the inflation adjustment imputation methodology
(advocated by the City’s expert Dr. Baar) which was used by the Park Owner to calculate
base year expenses:

With respect to expenses, Dr. Baar testified that 1986 real estate tax data is available from the tax collector’s office, he also opined that prior ground lease expenses could be extrapolated by using current data and adjusting for inflation. Given the available information concerning expenses, Dr. Baar concluded

1 that about eighty percent of it you can estimate pretty precisely.
(MHC Operating Limited Partnership v. City of San Jose, supra,
2 106 Cal.App.4th at 225)

3 The Commission incorrectly contends that the Commission Guidelines prevent it from
4 using the imputation methodology. The Guidelines do not require the Commission to reject
5 1979 as a base year if there is no actual 1979 expense data, but instead merely allow the Park
6 Owner, at the Park Owner's option, to substitute another base year:

7 In the event that the 1979 financial information is not
8 available, and where the loss of such records can be substantiated
9 by clear and convincing evidence, the landlord of record in 1979
10 may substitute as a base year the first year following 1979 for
11 which records are available. (RAC-2. § 4)

12 Indeed, the Commission Guidelines expressly prohibit the use of a different base year
13 unless there is a clear showing of good cause that 1979 net operating income (imputed or
14 otherwise) was not representative of net operating income during the pre rent control period:

15 The use of a base year other than calendar year 1979 shall
16 only occur upon the showing of good cause as shall be
17 determined within the discretion of the Rent Adjustment
18 Commission. Good cause shall include, but shall not be limited
19 to a showing that calendar year 1979 was not representative of
20 net operating income produced by the complex; that income
21 and/or expenses were unusually high or low during that period, in
22 that 1979 was otherwise aberrational. (RAC-5, §3.07)

23 **B. There is No Evidence to Support Another Base Year**

24 There was no evidence presented to show that 1979 expenses were not representative
25 of the 1979 pre rent control period. To the contrary, there was evidence that the City's own
26 expert considered the year 1979, even with its imputed net operating income, to be
27 acceptable and preferable for use as the base year.

28 Coldren: You're forced as an expert witness on the
record to select between '79 and '86 in this case tonight. What
do you select?

Baar: Okay. I would select 1979. (Administrative
Record ["AR"] CTO 02370, Lines 6-9)

Coldren: So now I want to move on to a quote from
your own report. On page 14 of your own report, it says "In this
case, use of the 1986 as a base year could undermine the purpose
of the regulations to use a pre-rent control base period." I'm
quoting that. Closed quote.

Is that an accurate statement? Is that one of the reasons
why you think that the base year should be '79?

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Baar: Yes. (AR CTO 02371, Lines 5-14)

While the imputation of base year expenses is not authorized under Thousand Oaks regulations, it is acceptable as a reasonable method in the administration of MNOI standards in other jurisdictions and it would be more in keeping with the overall purposes of the ordinance and regulations to insure the provision of adequate growth in net operating income over the pre-rent control level. (AR CTO 02082)

Therefore, the City's use of 1986 as the base year was in error, and 1979 should be used as the base year.

IV. THE COMMISSION CONCLUSION/FINDING THAT BASE YEAR RENTS CAN BE ESTABLISHED BY A "PRICE LEVEL ADJUSTMENT" IS CONTRARY TO THE LAW AND THE EVIDENCE.

A. Fair Market Base Year Rent Must Be Used As A Matter of Law

As noted above, the use of 1986 as a base year is an abuse of discretion and not supported by the evidence. To the extent 1986 is used as a base year, the Commission further abused its discretion by imputing 1986 rent contrary to the City's market rent appraisal.

Market rent must be used to determine base year rental income under the MNOI approach:

While the City's ordinance properly seeks to maintain the same rate of return which property owners experienced prior to the enactment of rent control with adjustments for inflation, a property owner must be permitted to start rent calculations with a base date rent similar to comparable properties. (See *Concord Communities, L.P. v. City of Concord* (2001) 91 Cal.App.4th 1407, 1419-1420 [emphasis added])

The City Guidelines concur that any rent adjustment must be to "full market value:"

Adjusted income for below market rentals is an amount representing the difference between the actual rent collected and what the landlord could have collected if the units had been rented at their full market value. (RAC-2, Sec. 2.05)

The City's Baar Report agrees that the Guidelines and case law require a base year income adjustment to full market value:

In Stardust Mobile Estates, LLC v. City of San Buenaventura, a Court of Appeal held that under a base rent adjustment provision

1 virtually identical to Section 2.05, a showing of “unique or
2 extraordinary” circumstances is not required. Therefore, if the
3 Commission finds that there was a difference between actual rent
4 and market rent in the base year, the Park Owner may be entitled
5 to a base rent adjustment pursuant to the regulations, rather than
6 on the “Vega” grounds that the Park Owner relies on. (AR CTO
7 02087)

8 The Commission use of a “price level adjustment” to 1986 rental income is not an
9 adjustment to full market value as required by case law and Section 2.05 of the Guidelines.
10 The City’s own appraiser appraised the full market rent value as of 1986 at \$320 per space
11 (AR CTO 02149), not at the \$298 per space improperly calculated by Dr. Baar under the
12 “price level adjustment.” (AR CTO 02106)

13 The use of a “price level adjustment” is appropriate only after the base year net
14 operating income has been determined and only when the base rent has not already been
15 adjusted to full market value pursuant to RAC-2, Section 2.05:

16 Add to the Net Operating Income for 1979, all automatic
17 adjustments of 8%, as permitted by Section VI of the Rent
18 Stabilization Ordinance which the landlord could have
19 implemented, which shall be known as the Price Level
20 Adjustment. (RAC-2, Sec. 3.04)¹

21 **B. There is No Evidence to Support Use of the Price Level Adjustment**
22 **Calculation as Base Year Rent**

23 The only appraisal testimony presented at the hearing concerning 1986 rents was by
24 Mr. Brabant, who opined that 1986 average rent for Thunderbird Oaks was \$320 per space.

25 The average monthly rent in 1986 for the eight parks
26 utilized in this analysis ranged from \$127 to \$344 per month....
27 Therefore, it is my opinion that the rental value of spaces at
28 Thunderbird Oaks, as of the year 1986, was \$320 per month,
which reflects an increase of \$43 over the actual 1986 average
rent. (AR CTO 02149)

The Commission rejected the Brabant appraisal and instead used a 1986 adjusted rent
figure of \$298 per space suggested by Dr. Baar, who testified that he is not an appraiser who
can determine market rent:

¹ It is important to note that Section VI of the Rent Stabilization Ordinance no longer specifies an automatic adjustment of 8%.

1 Coldren: Are you an appraiser”
2 Baar: No. (AR CTO 02382, Lines 22-23)

3 Therefore, if 1986 is used as the base year, the appraised full market value of \$320 per
4 space must be used, rather than the Baar “price level adjustment” approach.

5 The Baar suggestion of using a modified “price level adjustment” is not an acceptable
6 methodology for calculating base year full market rent. Full market rent must be based on
7 negotiation between landlord and tenant, not on rent control ordinance adjustment:

8 Neet: Market rent is established by negotiation between
9 landlord and tenant. (AR CTO 02403, Lines 4-5)

10 The Baar suggestion is based on an inaccurate assumption that actual 1979 rents were
11 at market:

12 Neet: And then staff just took it two steps further and
13 said, well, if it’s close enough, we’ll say that it’s—that rent was
14 at market. And of course staff is not a real estate appraiser. And
I don’t believe you have a real estate appraiser on staff. (AR
CTO 02408, Lines 18-22)

15 Given that 1979 must be used for the base year, the City must consider the appraisal
16 testimony of market rent for the 1979 base year. When determining 1979 base year rent, the
17 City Ordinance requires use of the highest rent as of June 1980:

18 “Maximum rent” the highest legal monthly rate of rent
19 which was in effect for the rental space during any portion of the
month of June 1980. (City Code, § 5-25.02 (k))

20 Mr. Neet presented his opinion and testified to a conservative average per space
21 market rent of \$225 per space for the 1979 base year. (AR CTO 00167)

22 Neet: So actually, if we want to know what true market
23 rents were in 1979, what we should be looking at is not the
24 average rents in the park, which is the basis for both Mr.
Brabant’s and my analysis, but the rents that are the highest rents
25 in the park simply because those were more likely to have been
the most recently negotiated rents. (AR CTO 02407, Lines 11-
17)

26 If Mr. Brabant’s appraisal for 1979 is adjusted to account for inflation to 1980, as
27 required by the City’s ordinance, then his market rent opinion for 1979 would be \$237 per
28 space:

1 Neet: But if you took Mr. Brabant's analysis, which is his
2 \$205, is based on going all the way back to 1979, not 1980,
3 there's just a subtle difference there.

4 I say in 1980, the rents probably weren't that much
5 different than in late 1979. Mr. Brabant says he's going all the
6 way back to 1979, which might explain part of our difference in
7 opinion.

8 If you took that inflation rate that he was to apply and
9 added that to his \$205 rent, you would get to \$237 in rent. (AR
10 CTO 02409, Line 20 through CTO 02410, Line 4)

11 Therefore, market value rent of at least \$225 per space should be used for the 1979
12 base year income.

13 **V. THE COMMISSION CONCLUSION/FINDING THAT BASE YEAR**
14 **EXPENSES SHOULD BE IMPUTED FROM CURRENT YEAR EXPENSES IS**
15 **CONTRARY TO THE LAW AND THE EVIDENCE.**

16 **A. Base Year Expenses Cannot Be Imputed From Current Year Expenses As**
17 **a Matter of Law**

18 The central feature of the MNOI formula is to provide rent increases for current year
19 increases in operating costs over inflation adjusted base year operating costs, because it is
20 presumed that the landlord's base year net operating income (which factors in operating
21 costs) provided a just and reasonable return. (See *Kavanau v. Santa Monica Rent Control*
22 *Bd., supra*, 16 Cal.4th at 768-769)

23 In order to maintain this net operating income at a constant level,
24 the law permits rent increases that will enable the landlord to
25 recoup increases in ongoing operating expenses. (*Kavanaugh v.*
26 *Santa Monica Rent Control Bd.* (2001) 16 Cal.4th 761, 769)

27 The Commission's use of a base year expense amount imputed from current year
28 expenses to compute base year NOI is contrary both to that central principle of compensating
29 for increased current operating costs and to the presumption that base year costs were
30 commensurate with a just and reasonable return.

31 The City regulations follow the MNOI formula by adopting a strong presumption that
32 base year NOI, including operating expenses, is accurate:

33 The Commission presumes that the net operating income
34 received up to April, 1980 provided landlords with a Just and

1 Reasonable Return on their rental units, unless there is clear and
convincing evidence to the contrary.” (RAC-2, Section 1.03)

2 Instead of following that presumption in favor of the Park Owner base year NOI, the
3 Commission reversed that presumption and instead imposed a presumption against the Park
4 Owner base year NOI:

5 [T]he Park Owner did not present convincing evidence that a
6 higher level of effort and expenditure was required in order to
7 perform management and administration in 2009 compared to
1986. (AR CTO 02323, ¶ 3(e))

8 The Baar methodology adopted by the Commission of imputing 1986 administrative
9 and management operating expenses by downward CPI adjusting the current year
10 administrative and management expense is not authorized by the City regulations and is
11 expressly contrary to the fundamental purpose of the MNOI formula, which is to provide a
12 just and reasonable return by adjusting current rents to account for increased current year
13 operating expenses and inflation. (See *Kavanau v. Santa Monica Rent Control Bd.*, *supra*,
14 16 Cal.4th at 769)

15 The base year expenses should not be determined by CPI downward adjustment from
16 the current year, which has a different level of management services. Use of current year
17 expense levels to determine base year expenses would defeat the whole purpose of the
18 MNOI approach, which is to determine whether a rent adjustment is required based on a
19 comparison between the current and base year level of expenses:

20 Therefore, landlords who have had such reasonable
21 increased operating expenses should be able to maintain the same
22 level of net operating income as they experienced in 1979 by
requesting a rent adjustment pursuant to these guidelines. (RAC-
2, § 1.03)

23 Therefore, the base year expenses should be those for the then existing level of
24 management services, as calculated by CPI downward adjustment from the 1986 actual
25 expenses to the 1979 base year, not as calculated by a CPI downward adjustment from the
26 2009 current year expenses, which current year xpenses represent a different level of
27 management expenses than existed in 1979.

1 The Baar methodology adopted by the Commission is not authorized by the
2 Guidelines. Adjustments to base year management and administrative operating expenses
3 are allowed only upon request by the Park Owner and only in the situation in which the Park
4 Owner is seeking to recover increased expenses in the current year that include self-
5 operation of the Park:

6 In addition to the actual Management and Administrative
7 Expenses listed in Sec. 2.10 above, where the landlord performs
8 such services, the landlord may calculate an expense figure
9 representing the value of such unpaid management and
10 administrative services. (RAC-2, Sec. 2.11)

11 Baar's contention that management and administrative expenses must be calculated at
12 the same percentage of actual income in both 1986 and current year is premised on a
13 misreading of Section 2.11. As Section 2.11 expressly provides, Section 2.11 applies only
14 when the Park Owner chooses to calculate an expense amount for unpaid management and
15 administrative services, and the same percentage analysis applies only when the Park Owner
16 provides substantially the same level of services in both the base and current year:

17 [A]nd where the landlord has performed substantially similar
18 services in both the base year and the current year, the foregoing
19 adjusted expenses must be calculated for both the base year and
20 the current year at the same percentage of actual rental income.
21 RAC-2, Sec. 2.11)

22 Here, the Park Owner presented evidence that it provided a different level of services
23 in 1986 and 2009, and the Park Owner did not seek to include costs for unpaid management
24 and administrative services. (AR CTO 00097-00098, Item 9 & CTO 00149)

25 **B. There Was No Evidence That There Were Not Reasonable Increased**
26 **Operating Expenses From the Base Year**

27 There was no evidence presented that the 1986 expenses were inaccurate or that
28 operating expenses had not increased from 1986. To the contrary, the evidence in the form
of a tax return (AR CTO 00202-00203) is entirely credible presumptive evidence of 1986
expenses. (Evid. Code, § 664)

Furthermore, the Park Owner presented expert opinion, based on review of the
financial reports, and based on his experience reviewing mobilehome park operating costs

1 over the years, that costs of mobilehome park operation had increased significantly since
2 1986:

3 McCarthy: Now, Section 2.11 of RAC-2 applies only if
4 the owner seeks a current year adjustment for management and
5 administrative expenses to account for uncompensated owner
6 management and administration. We're not doing that.

7 Section 2.11 of RAC-2 contains no mandatory language
8 requiring the owner make an adjustment for uncompensated
9 management and administrative expenses either for the current
10 year or the base year and contains no mandatory language
11 requiring an 8 percent cap if the owner does not seek such an
12 adjustment. Quote, "the landlord may calculate an expense
13 statement."

14 Thirdly, the requirement for a mandatory adjustment of an
15 8 percent management and administrative cap would be contrary
16 to the express purpose of the MNOI formula for just and
17 reasonable return to recoup increases in ongoing operating
18 expenses, including those caused by inflation.

19 Dr. Baar made a statement that expense adjustments
20 weren't valid for the—that expense adjustments are valid for the
21 base year somehow because expenses have changed.

22 If we—well, of course expenses have changed. I mean, if
23 doesn't make any sense because things have changed over the
24 last 30 years.

25 One of the issues is that owner management 30 years ago
26 was common. And after the—let's see—as regulations have
27 changed and so forth, over the last 30 years, we've seen a big
28 change in this industry where third party management is now
common.

So these expenses are not extraordinary or unusual for
management. These expenses are typical in the mobilehome
environment in 2009, 2010, and 2011. (AR CTO 02425, Line 7
through CTO 02426, Line 11)

Therefore, the Commission should have accepted the 1986 expenses as valid and not
imputed base year management and administrative expenses using current year expenses.

**VI. THE COMMISSION CONCLUSION/FINDING THAT BASE YEAR NOI
SHOULD ONLY BE 50% INFLATION ADJUSTED IS CONTRARY TO THE
LAW AND EVIDENCE**

**A. Adjustment of Base Year NOI at Only 50% of Inflation is Improper as a
Matter of Law**

The MNOI formula expressly requires that rent increases be imposed to account for
the decreased value of net operating income caused by inflation. (See *Kavanau v. Santa
Monica Rent Control Bd.*, *supra*, 16 Cal.4th at 769)

1 Neither the City Rent Adjustment Ordinance nor the City regulations allow for
2 inflation indexing of the base year NOI at anything less than 100% of the CPI increase in
3 applying the MNOI formula. No California case holds that an inflation index of less than
4 100% may be applied under the MNOI formula unless the City expressly adopts a lesser
5 percentage by ordinance.

6 Indeed, the City's own expert admits that there is no authority for indexing at less
7 than full CPI:

8 Coldren: This ordinance give no direction; isn't that
9 right?

10 Baar: That's correct. (AR CTO 02378, Lines 9-11)

11 Baar: The regulations adopted pursuant to the prior
12 Thousand Oaks ordinance in 1981, which are still in effect,
13 provide for the maintenance of net operating income, but do not
14 provide any specification as to the rate at which net operating
15 income shall be indexed. (AR CTO 02093)

16 The City's own expert admits that use of 100% CPI would be consistent with the
17 MNOI approach:

18 Baar: While this discussion sets forth rationale for
19 indexing at less than 100% of the rate of increase in the CPI, it
20 also should be noted that there are rationale for 100% indexing
21 principally based on the view that profits should be permitted to
22 grow at the same rate as the CPI increases and that such growth
23 in net operating income would not result in excessive rent
24 increases. (AR CTO 02099)

25 The City's expert could not provide any policy rationale for using less than 100% CPI
26 other than that he doesn't like the amount of the rent increase under the MNOI formula:

27 Coldren: And you're saying, look, you can pick 40
28 percent, you can pick 70 percent, 80 percent, 82.3 percent, or 100
percent. It's up to you. That's basically your position; is that
right?

Baar: Right. That's a policy decision.

Coldren: Okay. What factors should this Commission
consider in determining the policy? Keeping in mind what we're
trying to do now is maintain someone's net operating income as
it stood in 1979, what policy considerations?

Baar: I would say the overall purposes of the ordinance is
not to have excessive rent increases.

Coldren: Oh, just a second. Let me stop you there.
So in other words, if the result in calculation would lead to what
you consider to be an excessive rent increase, then they should
pick a lower CPI? Is that what you're telling us.

1 Baar: I'm saying that's one of the things that should be considered.

2 Coldren: I see. Okay. Anything else? Other than—other
3 than we're going to figure out what result we want, and then
4 we're going to figure out what result we want, and then we're
5 going to select the CPI factor to meet it, any other policy
6 considerations? (AR CTO 02373, Lines 2-24)

7 The City's expert attempted to incorporate a different formula not adopted by the City
8 to justify use of less than 100% CPI:

9 Coldren: Explain to me the policy and consideration
10 that warrants telling somebody that you're going to erode their
11 purchasing power over time?

12 Baar: Well, I think you have a situation that's different
13 because basically you're talking about a return on a basically
14 fixed investment. That's what you have. (AR CTO 02376, Line
15 23 through 02377, Line 4)

16 The City expert's attempt to use a different return on investment formula rather than
17 the MNOI formula adopted by the City is not authorized when applying the MNOI formula:

18 Applicants or tenants may propose the use of such
19 [alternative] approaches, but must fully explain, in writing, the
20 methodology and the reasons supporting use of the methodology,
21 and must provide information and documentation adequate to use
22 the suggested approach. (RAC-2, sec. 1.04)

23 The City expert's application of a return on investment approach is at odds with the
24 MNOI formula:

25 Coldren: Okay. And we do know—and we do know
26 that the beauty of the maintenance of net operating income
27 approach is that it doesn't take into account such vagaries and
28 such speculation as what's this piece of property going to be
worth in 5 or 10 years; does it?"

Baar: That's correct. (AR CTO 02383, Lines 19-25)

 The City expert's reliance on the *Berger* case is misplaced. In that case, the court
remanded the issue of what percentage inflation adjustment index to use back to the City,
without commenting on whether the City must adopt that percentage by ordinance or
otherwise. Furthermore, the court's dictum containing a discussion of factors to consider
would require the City in this instance, assuming it could act without adopting an ordinance,
to adopt at least a 75% inflation adjustment index. The court's discussion concluded that the
floor for such an index was the 60% amount for annual automatic rent increases contained in

1 the applicable ordinance. (*Berger v. City of Escondido* (2005) 127 Cal.App.4th 1, 10-11)
2 Here, the City's rent adjustment ordinance establishes a floor of 75% for annual automatic
3 rent increases (City Code, § 5-25.02 (g)), thus clearly excluding a 50% inflation adjustment
4 index.

5 **B. Adjustment of Base Year NOI at Only 50% of Inflation is Not Supported**
6 **by the Evidence**

7 The Baar suggestion that a 50% CPI adjustment could be applied is not supported by
8 the evidence:

9 McCarthy: Now, a 50 percent CPI adjustment to the
10 base year NOI would provide a significantly diminished return.
(AR CTO 02427, Lines 19-21)

11 McCarthy: Of course you get an increase, and you're
12 going to have a curve upward. So far so good. However, if you
look at the expenses, the expenses are going up by the rate of
inflation

13 And what happens is, is over time, the expenses begin to
14 overtake the revenue. (AR CTO 02428, Lines 18-23)

15 McCarthy: So at 50 percent of CPI, you're going to
16 reach a point where this park is no longer going to make a profit.
It's not going to be tenable for this park owner to continue
operating this park. (AR CTO 02429, Lines 19-22)

17 McCarthy: On the other hand, if you index rental
18 income by 100 percent, you achieve the goal of the exercise.
Revenue goes up by 5 percent a year, expenses will go up by 5
19 percent a year, you're going to have a steady, upward
maintenance of net operating income at 5 percent a year. (AR
20 CTO 02430, Lines 6-11)

21 McCarthy: I'd like to point out in the general U.S.
22 economy, 100 percent of CPI is standard. That applies to
47,800,000 social security recipients—I believe some of them are
23 here today—over 4,000,000 retired military and civil service
retirees, 22,400,000 food stamp recipients, 26,700,000 children
24 in the school lunch program, real estate leases in the private
sector that use CPI accelerators. Many of my clients have these.
Royalty payments for patents, intellectual property, etc., alimony,
25 child support, and adjustments to metrics used for Federal, state,
and local taxes. CPI is—the 100 percent CPI standard is well
26 established in the general economy. (AR CTO 02432, Lines 8-
20)

27 McCarthy: Dr. Baar assumes that the value of property
28 goes up because the NOI goes up because you've given the park
owner a 50 percent CPI increase.

1 But that's not really how the property values are
2 determined. Property values are determined by activities
3 between willing buyers and willing sellers, not necessarily this
4 capped rate formula that Dr. Baar uses. (AR CTO 02433, Lines
5 9-17)

6 Therefore, the base year NOI cannot be adjusted at 50% of CPI for purposes of
7 comparison to the current year NOI and calculation of applicable rent adjustment, but instead
8 100% must be used given that the City ordinance does not provide for a lesser percentage.

9 **VII. THE COMMISSION CONCLUSION/FINDING THAT A JUST AND**
10 **REASONABLE RETURN RENT INCREASE CAN BE PHASED IN IS**
11 **CONTRARY TO THE LAW**

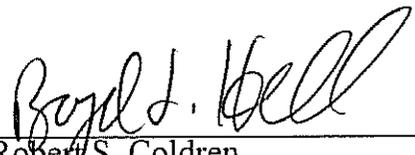
12 There is no provision in the City ordinance or regulations allowing for a phase-in of a
13 just and reasonable return rent increase. There was no finding or evidence presented in
14 support of a phase-in of the rent increase. (AR CTO 02326) A phase-in is contrary to the
15 constitutional requirement of a just and reasonable return. The evidence all points to the
16 need for an immediate increase of \$260.62 per space under the MNOI formula for
17 determining just and reasonable return.

18 **VIII. CONCLUSION**

19 In conclusion, the Commission findings and the decision based thereon were all in
20 error and were contrary to all of the expert opinion presented, including the opinions of the
21 City's own expert. AVMGH, Ltd. respectfully requests that the City Council grant the
22 appeal and grant the requested rent increase of \$260.62 per space.

23 Dated: April 13, 2011

HART, KING & COLDREN

24 By: 
25 _____
26 Robert S. Coldren
27 Boyd L. Hill
28 Attorneys for Applicant
AVMGH Ltd.

PROOF OF SERVICE

AVMGH, Ltd. [Thunderbird Oaks Mobilehome Park]

Case No. RAA-2010-01

STATE OF CALIFORNIA, COUNTY OF ORANGE

I am employed in the County of Orange, State of California. I am over the age of 18 years and am not a party to the within action. My business address is 200 Sandpointe, Fourth Floor, Santa Ana, California 92707-0507. On April 13, 2011, I caused the foregoing document(s) described as **AVMGH BRIEF ON APPEAL FROM RENT ADJUSTMENT COMMISSION DECISION** to be served on the interested parties in this action as follows:

by placing the original a true copy thereof enclosed in sealed envelopes addressed as stated below or by sending a copy as stated and addressed below:

SEE ATTACHED SERVICE LIST

BY MAIL: I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. Postal Service on that same day with postage thereon fully prepaid Santa Ana, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after date of deposit for mailing in the affidavit.

BY OVERNIGHT DELIVERY: I enclosed the documents in an envelope or package provided by an overnight delivery carrier and addressed to the persons identified herein. I placed the envelope or package for collection and overnight delivery at an office or a regularly utilized drop box of the overnight delivery carrier.

BY ELECTRONIC SERVICE. Based on a court order or an agreement of the parties to accept service by electronic transmission, I caused the documents to be sent to the persons at the electronic notification addresses listed herein on this date. I did not receive, within a reasonable time after the transmission, any electronic message or other indication that the transmission was unsuccessful.

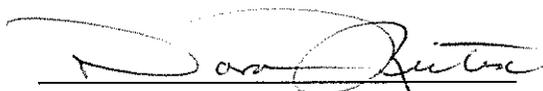
BY FACSIMILE: Based on an agreement of the parties to accept service by fax transmission, I faxed the documents from a fax machine, at Santa Ana, California, with the telephone number, (714) 546-7457 to the parties and/or attorney for the parties at the facsimile transmission number(s) shown herein. The facsimile transmission was reported as complete without error by a transmission report, issued by the facsimile transmission machine upon which the transmission was made, a copy of which is attached hereto.

BY PERSONAL SERVICE: I personally delivered the documents to the persons at the addresses listed herein. (1) For a party represented by an attorney, delivery was made to the attorney or at the attorney's office by leaving the documents, in an envelope or package clearly labeled to identify the attorney being served, with a receptionist or an individual in charge of the office, between the hours of nine in the morning and five in the evening. (2) For a party, delivery was made to the party or by leaving the documents at the party's residence with some person not younger than 18 years of age between the hours of eight in the morning and six in the evening.

BY MESSENGER SERVICE: I served the documents by placing them in an envelope or package addressed to the persons at the addresses listed herein and providing them to a professional messenger service for service. A declaration by the messenger will be filed separately.

[State] I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on April 13, 2011, at Santa Ana, California.


Dora Renteria

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A PROFESSIONAL LAW CORPORATION
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SANTA ANA, CALIFORNIA 92707

SERVICE LIST

AVMGH, Ltd. [Thunderbird Oaks Mobilehome Park]
Case No. RAA-2010-01

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