

PARK OWNER BRIEF

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CITY CLERK DEPARTMENT
CITY OF THOUSAND OAKS

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8 BEFORE THE CITY COUNCIL
9 OF THE CITY OF THOUSAND OAKS
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11 AVMGH FIVE LTD., a California Limited)
Partnership [Owner of Ranch Mobilehome)
12 Park],)

CASE NO. RAA-2010-01

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Applicant.

Date: May 24, 2011
Time: 6:00 p.m.
Place: Scherr Forum Theatre
City of Thousand Oaks
2100 Thousand Oaks Blvd.
Thousand Oaks, CA

HART, KING & COLDREN
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ORIGINAL

1 **I. INTRODUCTION**

2 AVMGH Five, Ltd., the owner of Ranch Mobilehome Park requests a monthly space
3 rent increase of \$466.12 per month in order to obtain a constitutionally required “just and
4 reasonable” return on its property. The City Code requires that the City’s Rent Adjustment
5 Commission (“Commission”) make a determination of the amount of space rent necessary to
6 obtain a “just and reasonable” return on mobilehome property. (City Code, § 5-25.06 (b))
7 The Commission determined that the Park Owner was entitled to a monthly space rent
8 increase of only \$191.95 per month, to be phased in over a seven year period at the annual
9 rate of \$27.42 per month, plus interest at the annual rate of 4% per annum on the deferred
10 rent increases.

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

- 14 1. That 1982 rather than 1979 should be used as the “base year”;
- 15 2. That base year rents should be determined by an adjustment for average park
16 rent increases rather than by fair market value;
- 17 3. That base year expenses should be imputed at the current year level of
18 expenses (as adjusted for inflation);
- 19 4. That the base year net operating income should be adjusted for only 50% of
20 inflation for purposes of comparison with the current year net operating
21 income in order to determine the amount of the applicable rent increase;
- 22 5. That the applicable rent increase may be phased in over a period of seven years
23 rather than immediately.

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

3 **II. THE MNOI FORMULA MUST BE CORRECTLY APPLIED IN ORDER TO**
4 **SATISFY THE CONSTITUTIONAL REQUIREMENT FOR A "JUST AND**
5 **REASONABLE RETURN"**

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

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

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

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

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.

1 **III. THE COMMISSION CONCLUSION/FINDING THAT 1982 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 1982 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.
2 (MHC Operating Limited Partnership v. City of San Jose, supra,
3 106 Cal.App.4th at 225)

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

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

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

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

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

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

The report presented by the City's own expert was that there was no aberration in the
1979 net income that would require use of another year:

Baar: The Park Owner contends that 1979 should be used
as the base year. As a practical matter, in this case the differences
between the outcomes with the use of 1979 and 1982 base years
are not substantial. (Administrative Record ["A.R."] CTO
01316 [emphasis added])

1 Indeed, the City's own expert opined that the use of 1979 would be more consistent
2 with the use of the required *Vega* adjustment that must be applied to this application:

3 Baar: The advantage of the use of 1979 as a base year is
4 that it would be consistent with the "Vega" concept of
5 establishing a pre-regulation base period for a fair base rent.
(A.R. CTO 01316)

6 Therefore, the City's use of 1982 as the base year was in error, and 1979 should be
7 used as the base year

8 **IV. THE COMMISSION CONCLUSION/FINDING THAT BASE YEAR RENTS**
9 **CAN BE ESTABLISHED BY AN AVERAGE PARK INCREASE**
10 **ADJUSTMENT TO A PRIOR YEAR APPRAISAL IS CONTRARY TO THE**
11 **LAW AND THE EVIDENCE.**

12 **A. Full Market Base Year Rent Must Be Used As A Matter of Law**

13 As noted above, the use of 1982 as a base year is an abuse of discretion and not
14 supported by the evidence. To the extent 1982 is used as a base year, the Commission
15 further abused its discretion by imputing 1982 rent from a non-market and non-base year
16 appraisal of average 1979 comparable rents and by not using a market rent appraisal for
17 either 1979 or 1982.

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

20 While the City's ordinance properly seeks to maintain the
21 same rate of return which property owners experienced prior to
22 the enactment of rent control with adjustments for inflation, a
23 property owner **must** be permitted to start rent calculations with
24 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])

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

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

1 Dr. Baar in his report to the City on the Thunderbird Oaks Rent Adjustment
2 Application concludes that the Guidelines and case law require a base year income
3 adjustment to full market value:

4 Baar: In Stardust Mobile Estates, LLC v. City of San
5 Buenaventura, a Court of Appeal held that under a base rent
6 adjustment provision virtually identical to Section 2.05, a
7 showing of "unique or extraordinary" circumstances is not
8 required. Therefore, if the Commission finds that there was a
9 difference between actual rent and market rent in the base year,
10 the Park Owner may be entitled to a base rent adjustment
11 pursuant to the regulations, rather than on the "Vega" grounds
12 that the Park Owner relies on. (Thunderbird Oaks A.R. CTO
13 02087)

10 As the appraiser Mr. Neet testified, the establishment of full market rent requires
11 review of the highest rents charged at the time in comparable parks:

12 Neet: For that reason, the use of the highest rents in the
13 park at that particular time is the appropriate tool, that's the
14 appropriate number to begin with a base for 1983 and 1986.
15 Because we know that to use average rents is going to throw in
16 all of those tenants that may have resided in some of these parks
17 for 20 years prior to that time and get --- and involve the rent
18 that they're paying that may not be an indication of market rent.
19 (A.R. CTO 02456, Line 20 through 02457, Line 2)

17 **B. There is No Admissible Evidence to Support Use of the Baar Adjustment**
18 **Calculation as 1982 Full Market Rent**

19 The City's appraiser failed to provide an appraisal for full market rent as of 1982:

20 [T]he appraisals do not include projections of appropriate
21 base year adjustments for 1982 (A.R. CTO 01298)

22 Full Market Rent for 1982 must be determined by comparable full market rents as of
23 1982:

24 For the purpose of determining the capitalized value of the
25 reasonable net rental value attributable to the property interest
26 being valued as provided in Section 819, or determining the
27 value of a leasehold interest, a witness may take into account as a
28 basis for his opinion the rent reserved and other terms and
circumstances of any lease of comparable property if the lease
was freely made in good faith within a reasonable time before or
after the date of valuation. (Evid. Code § 818)

1 Neet: Therefore, the market rents in the subject should at
2 least achieve the level of the highest rents in those two parks,
3 which were inferior. It only makes sense. Nobody's going to
4 pay less for a superior product, or nobody should pay less for a
5 superior product. (A.R. CTO 02458, Lines 1-5)

6 Rather than obtain an appraisal of full market rent for 1982, the Commission abused
7 its discretion by relying on Dr. Baar's inappropriate non-appraisal methodology to impute
8 1982 market rents. According to that methodology, Dr. Baar applied a 6% per year
9 adjustment to what Mr. Brabant claims are 1979 market rents:

10 Baar: While the appraisals did not include projections of
11 appropriate base rent adjustments for 1982, the methodology of
12 the City's appraiser may be used to determine what the
13 projection for 1982 would have been if that year had been
14 included in his analysis.

15 The City's appraiser projected that rents in the comparable
16 parks increased by 6% per year from 1979 to 1982. On this
17 basis, the comparable base rent for Ranch would have increased
18 by 6% per year over the projected level of \$150 in 1979. In
19 1982, the projected comparable rent would be \$178.65. (A.R.
20 CTO 01298)

21 There are four major problems with the Baar methodology. First, Dr. Baar lacks
22 foundation as a qualified expert appraiser and therefore cannot provide an opinion about
23 1982 full market rent nor about appropriate appraisal methodology, as he candidly admits:

24 Hill: Mr. Baar, are you an appraiser?

25 Baar: No, I'm not.

26 Hill: Have you ever been qualified to testify on market
27 rents?

28 Baar: No, I'm not an appraiser. I don't think I could
qualify to testify on that.

Hill: Is your report - your report, on page 22, includes
an estimate of market value for 1982; is that correct?

Baar: Well, just a minute - yeah, I used data that Mr.
Brabant's supplied.

Hill: did you use proper appraisal techniques to come up
with the number you did?

Baar: No. (A.R. CTO 02176, Lines 2-16)

29 In order to provide an expert appraisal opinion, Dr. Baar would have to be qualified as
30 an expert appraiser and use appropriate appraisal methodology, which he is not and did not
31 do:

32 A person is qualified to testify as an expert if he has
33 special knowledge, skill, experience, training, or education

1 sufficient to qualify him as an expert on the subject to which his
testimony relates. (Evid. Code § 720 [in pertinent part])

2 If a witness is testifying as an expert, his testimony in the
3 form of an opinion is limited to such an opinion as is based on
4 matter ... that is of a type that reasonably may be relied upon by
an expert in forming an opinion upon the subject to which his
testimony relates. (Evid. Code § 801 (b) [in pertinent part])

5 The court may, and upon objection shall, exclude
6 testimony in the form of an opinion that is based in whole or in
7 significant part on matter that is not a proper basis for such an
opinion. (Evid. Code § 803)

8 The second problem with the Baar methodology is that use of average rent increase
9 for a post-rent control time period will not achieve market rent; i.e., they are not based on
10 rents of comparable properties "freely made in good faith" (Evid. Code § 818) but on rents
11 of comparable properties limited by the amount of rent increase to a percentage specified in
12 the then applicable rent adjustment ordinance. Baar's use of the Brabant methodology is not
13 appropriate. The Brabant methodology is used by Brabant to back into and determine
14 comparable park market rents for 1979 prior to the City's rent adjustment ordinance, not to
15 determine on a forward looking basis what should be the market rent for years after 1979
16 when the City's ordinance was already in effect and limiting annual rent increases.

17 The third problem with the Baar methodology is that it uses Brabant's calculations of
18 average rent increases for the period 1983-1986 to estimate average rent increases for the
19 period 1979-1982. The Brabant report does not calculate average rent increases for the time
20 period of 1979-1982, but instead calculates average rent increases for the time period of
21 1983-1986.

22 Brabant: In order to conduct a comparative analysis for
23 the base year of 1979 it is necessary to adjust the rental data we
do have for the closest two years of 1983 and 1986. (A.R. CTO
01352)

24 Brabant: This would easily support an average annual
25 increase of about 6.5 to 7.0 percent for the three years between
26 1983 and 1986. This same level of increase has then been
utilized to adjust the rents at these five parks back to the base
27 year of 1979. (A.R. CTO 01353)

1 The Brabant calculations of average rent increase for 1983-1986 are without
2 foundation as to whether they are determinative of the average rent increases for 1979-1982.
3 (Evid. Code § 403) That is especially true given that the City's Rent Adjustment Ordinance
4 was changed in 1983 to reduce the automatic annual increase from 8% per year down to 7%
5 per year. Baar's use of a 6% annual increase is even lower than the 6.5-7% annual increase
6 calculated by Brabant.

7 The fourth problem with the Baar methodology is that he relies on the Brabant 1979
8 appraisal as the starting point for his analysis. The Brabant 1979 appraisal is flawed in three
9 respects.

10 First, it does not use the correct time period of June 1979 through June 1980 for the
11 1979 Base Year as specified by the City Ordinance. When determining 1979 base year rent,
12 the City Ordinance requires use of the highest rent as of June 1980:

13 "Maximum rent" 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. (City Code, § 5-25.02 (k))

16 Second, the Brabant 1979 appraisal relies on average rents for comparable properties,
17 not on rent transactions "freely made in good faith" during the 1979 Base Year.

18 Neet: Average rent is what Mr. Brabant describes as the
19 average rent in all the parks or in a particular park. It's not really
20 a valuation concept, it's – it's a fact. It's something that, you
21 know, we can add all the numbers up, divide by the number of
22 spaces and that's the – that's the average rent. It doesn't tell us
23 when that was negotiated. It doesn't tell us whether it was
24 effected by rent control or anything else.

25 Commonly the term that Mr. Brabant – or the concept that
26 Mr. Brabant describes as average rent is also called restricted or
27 inhibited market rent. In other words, it's not a real market rent.
28 It's a market rent in that the facts are derived by survey
methodology in the same way. You go out and see, well, what
are they charging? However, the rents do not come from a
meeting of the minds between the landlord and the incoming
tenant. They come from a meeting of the minds of a city board
like this that says this is the rent you will charge. (A.R. CTO
02459, Line 10 through 02460, Line 2)

29 Third, the Brabant 1979 appraisal ignores Brabant's own comparable data and instead
30 appraises the market rent in an amount significantly below two of the inferior comparable
31 properties:

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Neet: Now, that differs somewhat from the subjects – from the expert of the City, Mr. Brabant, who’s concluded that market rent is \$150. If I could just point out that in Mr. Brabant’s report he concluded that Elm’s Plaza and Twin Oaks were both inferior properties to the Ranch. I think it’s very clear in his report that he believes those two properties are inferior to the subject.

Therefore, the market rents in the subject should at least achieve the level of the highest rents in those two parks, which were inferior. It only makes sense. Nobody’s going to pay less for a superior product, or nobody should pay less for a superior product.

In this case, Elms Plaza and Twin Oaks, once the adjustments are applied to the 1983 and 1986 high rent sin the parks, we find that in all likelihood there were rents of \$156 to \$171 in those two inferior parks. For this reason, I believe – I disagree completely with Mr. Brabant’s conclusion that a market rent of \$150 is appropriate. It simply is not supported by the facts on the ground. (A.R. CTO 02459, Line 19 through 02460, Line 13)

When considering the flaws in the Brabant appraisal opinion for 1979 market rent and in the inappropriate Baar methodology for estimating 1982 market rent tiered from the Brabant appraisal, both the Baar estimate and the Brabant appraisal must be rejected.

The only credible market rent appraisal presented for the only appropriate Base Year of 1979 was that presented by Mr. Neet at \$200 per space:

Neet: Once we have positioned that, once we have adjusted the rents, the – the – the highest rents of the park down to the 1979, ’80 levels by the increase factor cited in the ordinance, my conclusion is that the market rent for the Ranch – the spaces of the Ranch Mobile Home Park is – in 1979, 1980, prior to rent control is \$200. (A.R. CTO 02455, Lines 13-18)

Neet: For this reason I suggest that Mr. Brabant’s work, for the reasons I stated, the fact that there are rents in other parks that he rates as inferior that are higher than his conclusion of market rent and for the reason of this confusion of average rent versus market rent, that his estimate of market rent is conservative to the point of not being well supported. (A.R. CTO 02462, Lines 1-7)

In summary, based on the only admissible evidence and the applicable provisions of the City’s Ordinance and Guidelines, market value rent of at \$200 per space should be used for the 1979 base year income.

1 V. THE COMMISSION CONCLUSION/FINDING THAT BASE YEAR
2 EXPENSES SHOULD BE IMPUTED FROM CURRENT YEAR EXPENSES IS
3 CONTRARY TO THE LAW AND THE EVIDENCE.

4 A. Base Year Expenses Cannot Be Imputed From Current Year Expenses As
5 a Matter of Law

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

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

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

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

20 The Commission presumes that the net operating income
21 received up to April, 1980 provided landlords with a Just and
22 Reasonable Return on their rental units, unless there is clear and
convincing evidence to the contrary." (RAC-2, Section 1.03)

23 Instead of following that presumption in favor of the Park Owner base year NOI, the
24 Commission reversed that presumption and instead imposed a presumption against the Park
25 Owner base year NOI:

26 Because of the gap in available information, 1982 operating
27 expenses should be increased to a level which limits the rate of
28 operating expenses increases from 1982 to 2009 at the rate of
increase of the CPI. (A.R. CTO 02079, ¶ I.D.3.(f))

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1 The Baar methodology adopted by the Commission of imputing 1982 administrative
2 and management operating expenses by downward CPI adjusting the current year
3 administrative and management expense is not authorized by the City regulations and is
4 expressly contrary to the fundamental purpose of the MNOI formula, which is to provide a
5 just and reasonable return by adjusting current rents to account for increased current year
6 operating expenses and inflation. (See *Kavanau v. Santa Monica Rent Control Bd.*, *supra*,
7 16 Cal.4th at 769)

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

13 Therefore, landlords who have had such reasonable
14 increased operating expenses should be able to maintain the same
15 level of net operating income as they experienced in 1979 by
16 requesting a rent adjustment pursuant to these guidelines. (RAC-
17 2, § 1.03)

18 Therefore, the base year expenses should be those for the then existing level of
19 management services, as calculated by CPI downward adjustment from the 1982 actual
20 expenses to the 1979 base year, not as calculated by a CPI downward adjustment from the
21 2009 current year expenses, which current year expenses represent a different level of
22 management expenses than existed in 1979.

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

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

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

7 [A]nd where the landlord has performed substantially similar
8 services in both the base year and the current year, the foregoing
9 adjusted expenses must be calculated for both the base year and
10 the current year at the same percentage of actual rental income.
11 (RAC-2, Sec. 2.11)

12 Here, the Park Owner presented evidence that it provided a different level of services
13 in 1982 and 2009, and the Park Owner did not seek to include costs for unpaid management
14 and administrative services. (AR CTO 01727-01729)

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

17 There was no evidence presented that the 1982 expenses were inaccurate or that
18 operating expenses had not increased from 1982. To the contrary, the evidence in the form
19 of the City's own finding as to 1982 expenses (AR CTO 00032) is entirely credible
20 presumptive evidence of 1986 expenses. (Evid. Code, § 664)

21 The City is bound by its prior determination in the Martello memorandum of the 1982
22 NOI and expenses:

23 Hill: And in that memorandum, summarized the City's
24 review of the Ranch's 1982 gross income and net operating
25 expenses, and concluded by finding and establishing what would
26 be the net operating income under the City rent control
27 ordinance, did it not?

28 Baar: That's my understanding of it. (A.R. CTO 02177,
Lines 4-9)

29 The City cannot now come back thirty years later and attempt to re-write history.
30 Therefore, the City must accept its prior determination of the 1982 expenses and adjust those
31 expenses downward to the 1979 base year.

1 Furthermore, the City is bound by its own expert's determination that the 2009
2 expenses are within reason:

3 Baar: While the percentage expense increase from 1982
4 to 2009 exceeded the percentage increase in the CPI, the overall
5 expense/rental income for 1999 is moderate by mobilehome park
6 industry standards, although nearly equaling the current
7 exceptionally low rent levels. If the 2009 operating expenses are
8 compared with the lowest of the projected rent increases under
9 the MNOI standard, they would be equal to about 34% of the
10 allowable rent. In this analysis, no adjustment is made to the
11 2009 operating expenses claimed by the applicant. (A.R. CTO
12 01298)

13 Therefore, to summarize regarding Base Year expenses, the Commission should have
14 accepted its prior closer in time 1984 finding regarding the 1982 expenses as valid and
15 should not have imputed 1982 management and administrative expenses using 2009 current
16 year expenses.

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

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

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

25 Neither the City Rent Adjustment Ordinance nor the City regulations allow for
26 inflation indexing of the base year NOI at anything less than 100% of the CPI increase in
27 applying the MNOI formula. No California case holds that an inflation index of less than
28 100% may be applied under the MNOI formula unless the City expressly adopts a lesser
percentage by ordinance.

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

1 Hill: Mr. Baar, isn't it true that you apply a 50 percent
2 inflation indexing adjustment to base year net operating income,
despite the fact that no such reduced inflationary standard is set
forth in either the City's ordinance or regulations?

3 Baar: Well, I believe that the ordinance and regulations
4 say that base period net operating income is presumed to provide
a fair return, and there's no provision in the ordinance or
regulations setting forth how much indexing is required. That's
my reading of the ordinance.

5 Hill: This ordinance gives no direction; isn't that right?

6 Baar: That's correct. (A.R. CTO 02181, Lines 10-20)

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

9 Baar: While this discussion sets forth rationale for
10 indexing at less than 100% of the rate of increase in the CPI, it
11 also should be noted that there are rationale for 100% indexing
12 principally based on the view that profits should be permitted to
grow at the same rate as the CPI increases and that such growth
in net operating income would not result in excessive rent
increases. (A.R. CTO 01305)

13 The City's expert expressly stated that the use of a return on investment formula
14 should not be a policy reason to support less than a 100% CPI adjustment to the base year net
15 operating income under the MNOI formula:

16 Baar: However, the individual financing arrangements of
17 a park owner should not impact the outcome of the issue of the
appropriate rate of indexing of net operating income. Indexing is
18 based on a theory about what is appropriate for all park owners
and that the rate of growth in net operating income should be
19 equal for all park owners and should not be dependent on the
financing arrangements of the individual park owner. If the rate
20 of indexing was tied to the cash and financial portions of
investments in parks, the rate could be manipulated.
21 Furthermore, the Courts have held that differences in allowable
rents based on differences in financing arrangements have no
22 rational basis. (A.R. CTO 01305)

23 However, that is exactly what the City's expert did, i.e., attempt to use a return on
24 investment formula as a policy reason to justify application of less than 100% CPI
25 adjustment to the base year net operating income under the MNOI formula::

26 Baar: if the Park is granted a rent increase of \$252 (an
27 amount authorized pursuant to the MNOI standard with a
"median") (75%) indexing ratio, the rate of return on the inflation
28

1 adjusted investment would be 13.3%, and the rate of return on
2 the historic investment would be 48.8%. (A.R. CTO 01314)

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

5 Applicants or tenants may propose the use of such
6 [alternative] approaches, but must fully explain, in writing, the
7 methodology and the reasons supporting use of the methodology,
8 and must provide information and documentation adequate to use
9 the suggested approach. (RAC-2, sec. 1.04)

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

12 Baar: The MNOI formula provides for reasonable growth
13 in net operating income, which is the portion of rental income
14 that provides cash flow and covers debt service. Rather than
15 considering each owner's particular purchase price or financing
16 circumstances, it provides all owners with growth in net
17 operating income tied to the rate of inflation (the CPI) which can
18 cover additional debt service and/or provide additional cash flow.
19 (A.R. CTO 01289)

20 McCarthy: Dr. Baar uses a return on investment
21 approach to apply 50 percent CPI as I've shown as an adjustment
22 to the base year NOI. Now, that's inconsistent with the MNOI
23 approach. (A.R. CTO 02473, Lines 17-20)

24 McCarthy: Now he [Baar] also admits that the return on
25 investment approach disfavors longer term owners with low
26 investment such as our owner here. This owner – the original
27 investment was made, I believe, in 1976, and a return on
28 investment is not going to make any sense because the
investment, compared to current dollars, is so small that almost
any return in modern dollars is going to look like a great return,
which it's not. (A.R. CTO 02474, Lines 6-13)

29 The City expert's reliance on the *Berger* case is misplaced. In that case, the court
30 remanded the issue of what percentage inflation adjustment index to use back to the City,
31 without commenting on whether the City must adopt that percentage by ordinance or
32 otherwise. Furthermore, the court's dictum containing a discussion of factors to consider
33 would require the City in this instance, assuming it could act without adopting an ordinance,
34 to adopt at least a 75% inflation adjustment index. The court's discussion concluded that the
35 floor for such an index was the 60% amount for annual automatic rent increases contained in
36 the applicable ordinance. (*Berger v. City of Escondido* (2005) 127 Cal.App.4th 1, 10-11)

1 Here, the City's rent adjustment ordinance establishes a floor of 75% for annual automatic
2 rent increases (City Code, § 5-25.02 (g)), thus clearly excluding a 50% inflation adjustment
3 index.

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

6 The Baar suggestion that a 50% CPI adjustment could be applied is not supported by
7 the evidence and is contrary to the constitutional requirement for a just and reasonable
8 return:

9 McCarthy: What this chart shows is the effect of 50
10 percent indexing on the net operating income of a mobile home
11 park.... You reach a point around year 40, right there, where
12 expenses will out strip revenue. Now this park is actually very
13 close to this point at this --right now. (A.R. CTO 02470, Lines 3-
14 4 & 11-17; See Charts at A.R. CTO 01730-01732)

13 McCarthy: That in general U.S. economy 100 percent
14 of CPI is pretty much the standard for adjustments for many
15 things in the economy. A lot of these things are governmental
16 adjustments, I would like to point out. Approximately 48 million
17 social security recipients get a 100 percent increase in the CPI.
18 Four and a half million retired military and federal -- civil service
19 retirees, approximately 22 million food stamp recipients,
20 approximately 27 million children in the school lunch program.
21 Real estate leases in the private sector use CPI accelerators.
22 Royal payments for patents, intellectual property, et cetera,
23 alimony, child support, and adjustments used to the metrics for
24 federal, state and local taxes. (A.R. CTO 02471, Lines 7-19)

19 McCarthy: [I]n his report he [Baar] says that with a 50
20 percent CPI increase and a property value increase of 25 percent
21 the park owner will enjoy an 83 percent increase in equity....
22 [W]hat happens if the value of the property goes down? So if the
23 value of the property goes down 10 percent ... the equity in the
24 property actually goes down 33 percent. So the [Baar model]
25 really doesn't hold in a falling value environment. Also, Dr.
26 Baar bases his model on a capitalization rate to [determine] the
27 value of the property. In other words, this is how -- this is how
28 the property value is determined in his model. Well, I would
argue that that's -- that is rarely the value of a rental property. A
rental property is -- is determined by willing buyers matched up
with willing sellers to agree on a price. (A.R. CTO 02472, Line
18 through 02473, Line 6)

1 Therefore, the base year NOI cannot be adjusted at 50% of CPI for purposes of
2 comparison to the current year NOI and calculation of applicable rent adjustment, but instead
3 100% must be used given that the City ordinance does not provide for a lesser percentage.

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


7 There is no provision in the City ordinance or regulations allowing for a phase-in of a
8 just and reasonable return rent increase. There was no finding or evidence presented in
9 support of a phase-in of the rent increase. (A.R. CTO 02081) A phase-in is contrary to the
10 constitutional requirement of a just and reasonable return. The evidence presented by the
11 Park Owner was that the Park Owner net income is only \$1,583 per month (A.R. CTO
12 01274), far less than what is necessary and appropriate to maintain the Park in existence.
13 The Park Owner presented evidence that given that net income, the entire Park is only
14 currently valued at \$168,000, less than the value of some of the mobilehomes in the Park.
15 (See A.r. CTO 01679) The Park Owner also presented evidence that a phase-in of only five
16 years would result in lost revenues in the hundreds of thousands of dollars. (A.R. CTO
17 01733) The evidence all points to the need for an immediate increase in the full amount of
18 \$466.12 allowable under the MNOI formula for determining just and reasonable return.

19 **VIII. CONCLUSION**

20 In conclusion, the Commission findings and the decision based thereon are all in error
21 and were contrary to all of the admissible evidence and expert opinion presented, including
22 the opinions of the City's own expert. AVMGH Five, Ltd. respectfully requests that the City
23 Council grant the appeal and grant the requested rent increase of \$466.12 per space.

24 Dated: May 10, 2011

HART, KING & COLDREN

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

PROOF OF SERVICE

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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. On May 10, 2011, I caused the foregoing documents(s) described as: **AVMIGH FIVE, LTD. BRIEF ON ITS 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 on the ATTACHED SERVICE LIST.

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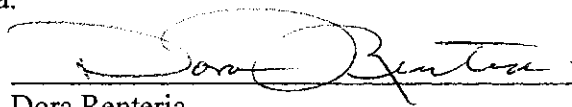
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[State] I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on May 10, 2011, at Santa Ana, California.


Dora Renteria

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