Rent Stabilization Board
Legal Department

MEMORANDUM

DATE: May 7, 2018

TO: Honorable Members of the Berkeley Rent Stabilization Board

FROM: Matt Brown, Staff Attorney
Bren Darrow, Staff Attorney

SUBJECT: Proposed Amendments to Regulation 1267 [Capital Improvements] – Second Reading

Recommendation:

That the Board adopt proposed amendments to Rent Board Regulation 1267 that would assist some landlords in covering the cost of seismic retrofits of potentially hazardous buildings by facilitating capital improvements petitions for work completed to achieve compliance with Berkeley's Seismic Retrofit and Soft-Story Ordinances. The full Board voted unanimously to adopt these proposed amendments on first reading at the April 16, 2018 Board meeting.

Background and Need for Rent Stabilization Board Action:

The City of Berkeley is located on the Hayward Fault, which along with the Rogers Creek Fault is regarded by the United States Geological Survey as most likely to produce a large earthquake in the Bay Area. The most recent major earthquake on the Hayward Fault in 1868 was one of the most destructive in California history, despite the sparse population of the Bay Area at that time. The USGS posits that the most comparable modern earthquake is the 1995 Kobe earthquake in Japan, which killed more than 5,000 people and required more than a decade to rebuild lost buildings.[1]

Recognizing the serious threat posed to Berkeley by an earthquake, the City Council has repeatedly imposed requirements upon landlords that would protect the lives of tenants and neighbors in the event of a catastrophic earthquake. On December 12, 2000 Council mandated that unreinforced masonry buildings be retrofitted. On October 25, 2005, Council enacted the Soft-Story Ordinance, which identified and recommended retrofits to over 400 buildings made

[1] Brocher, Boatwrigtht, Lienkaemper, et al., "Understanding Earthquake Hazards in the San Francisco Bay Region: The Hayward Fault—Is it Due for a Repeat of the Powerful 1868 Earthquake?" U.S. Geological Survey Fact Sheet 2008-3019, Version 1.0, available at: https://pubs.usgs.gov/fs/2008/3019/fs2008-3019.pdf

hazardous by soft, weak or open front stories. On December 5, 2013, Council determined that "it is essential for the safety of its residents to make . . . seismic hazard mitigation standards mandatory for multi-unit residential buildings" and enacted a mandatory timeline for soft-story buildings be retrofitted.[2]

The Berkeley Rent Stabilization Board has often expressed support for City efforts to achieve seismic safety. Regulation 1267 expressly permits landlords to petition for rent increases to cover the cost of seismic retrofit work. However, as demonstrated by the recent petition, *St. Hieronymus Press, Inc., et al. v. Skeels, et al.* (L-4222, 1902 Virginia St.); some landlords find themselves unable to qualify for capital improvements rent increases after making major expenditures to comply with the new seismic safety rules.

Summary of Proposed Amendments:

In recognition of the City's goal of achieving compliance with seismic retrofit laws, as well as the unique challenges faced by landlords who own twelve or fewer units in paying for seismic retrofits, we recommend that the Board ensure that small landlords can recover the costs of seismic retrofits. We therefore recommend that the Board enact a regulation creating an exception to the vacancy rent increase offset for capital improvements petitions filed by small landlords who comply with Berkeley's seismic retrofit and soft-story ordinances (Berkeley Municipal Code Sections 19.38 and 19.39).

Eligibility for the exception would be limited as follows:

1. The exception shall only apply to work that is timely performed in accordance with the requirements of the seismic and soft-story ordinances. Timely performance shall be defined as completion of work after no more than two notices informing the owner of non-compliance with Sections 19.38 or 19.39.
2. Incidental work not explicitly required by Sections 19.38 or 19.39 shall be eligible for exception only if such work has been mandated by the City as part of the permitting process, and not as the result of outstanding code violations.
3. The exception is limited to owners whose interest pre-dates the City's imposition of mandatory seismic retrofit requirements. (December 12, 2000 for Section 19.38 or December 5, 2013 for Section 19.39).
4. The exception is limited to owners of no more than 12 rental units in Berkeley.

Conclusion:

Given the rate of tenant and property-owner turnover in Berkeley, the number of tenants who may be required to pay any increase associated with seismic work will be limited and finite. Compared with the safety risk posed by seismically unsafe buildings the Board has indicated that this is a policy it wishes to promote.

[2] Berkeley Municipal Code Section 19.39.010.B.18.

The Proposed Regulation 1267 is attached, with the underlined amendments appearing on page 11.

Name and Telephone Number of Contact Person:

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Rent Stabilization Board

1267. Capital Improvements
(A) Purpose

The purpose of this section is to encourage landlords to improve the quality of their rental housing and to ensure that landlords receive a fair return on their capital expenditures.

(B) Capital Improvement

For purposes of this subchapter, a capital improvement shall be any improvement to a unit or property which materially adds to the value of the property, appreciably prolongs its useful life or adapts it to new use and has a useful life of more than one year and a direct cost of $200.00 or more per unit affected, or $1,500.00, whichever is less. Except as provided in subsection (E)(2), no rent adjustment shall be granted under this section for routine repair, replacement or maintenance including but not limited to interior and exterior painting; plastering and replacing broken windows; replacement of drapes and carpets; cleaning; fumigation; routine landscaping; repair of all standard services, including electrical repairs, plumbing repairs, and carpentry; and repair and replacement of furnished appliances.

(C) Policy

The rent ceilings for a unit or property shall be adjusted upward to provide a fair return on expenditures for capital improvements, where such capital improvements:

(1) are necessary to bring the unit or property into compliance with applicable new code requirements or significantly improve the security of the property or any unit, provided that in determining the cost of a capital improvement no consideration shall be given to any additional cost incurred for increased property damage and/or deterioration resulting from an unreasonable delay in the undertaking or completion of any repair or improvement; or

(2) have as their primary purpose to significantly improve the seismic safety of the rental property or increase the energy efficiency of the rental property (including any improvement to allow a significantly more accurate allocation of utility costs), provided that in determining the cost of a capital improvement no consideration shall be given to any additional cost incurred for increased property damage and/or deterioration resulting from an unreasonable delay in the undertaking or completion of any repair or improvement; or

(3) are provided by the landlord in good faith to primarily benefit the tenant(s). There shall be a rebuttable presumption that a specific capital improvement is so provided if it has been approved in writing by tenants in a majority of the units affected.

(4) The rent adjustments authorized under this regulation are intended to provide a fair return on capital expenditures for improvements and repairs to rental units that have had their rent ceilings continuously controlled under the Rent Ordinance. For a rental unit that has an initial rent

established pursuant to the Costa-Hawkins Rental Housing Act on or after January 1, 1999, the initial rent so established, having been set under unregulated, market conditions, is presumed to provide the landlord of that unit with a fair return on expenditures for improvements and repairs that were completed at the unit or reasonably anticipated prior to the establishment of the initial rent. In addition, to the extent that vacancy increases imposed at a property on or after January 1, 1999, pursuant to the Costa-Hawkins Rental Housing Act, result in rent ceilings that exceed the return that would be obtained from rent ceilings that were continuously controlled, the rent adjustments authorized under this regulation may not be necessary in order to obtain a fair return on capital expenditures at the property. Accordingly, rent adjustments otherwise authorized under this regulation for improvements or repairs at such properties shall be modified as provided in subsection (I).

(D) Rent Ceiling Adjustments for Capital Improvements

Where a landlord demonstrates that an improvement affecting a rental unit qualifies as a capital improvement under subsections (B) and (C), the lawful rent ceiling for such unit shall be permanently increased by 1.042% of the documented cost of the improvement attributable to that unit. The cost of repairs necessarily performed in conjunction with the approved capital improvement shall be included in the cost of the capital improvement.

(E) Major Long-term Repairs

(1) A landlord's expenditure for any of the major long-term repairs listed in (E)(2), to the extent that they are reasonably necessary for the proper maintenance of the property, shall qualify for a permanent increase in the rent ceiling. The increase for exterior painting and siding (subsection (E)(2)(d)) shall be equal to the cost of the major repair amortized over ten years, with interest imputed at 7.5% per annum. (The monthly increase shall be equal to 1.187% of the cost of the major repair.) The increase for the other major repairs listed below in subsection (E)(2) shall be equal to the cost of the major repair amortized over fifteen years, with interest imputed at 7.5% per annum. (The monthly increase shall be equal to .927% of the cost of the major repair.) The cost of repairs necessarily performed in conjunction with the approved major long-term shall be included in the cost of the major long-term repair. Nothing in this section shall preclude a landlord from seeking an NOI adjustment under Regulation 1264, however, any repair for which a rent adjustment is granted under this Subsection shall not qualify as a maintenance or operating expense under Regulation 1265.

(2) The following major repairs shall be eligible for the rent adjustment specified in Subsection (E)(1):

(a) a new roof covering all or substantially all of a building or a structurally independent portion of a building;

(b) a significant upgrade of the foundation of all or substantially all of a building or a structurally independent portion of a building;

(c) a new or substantially new plumbing, electrical or heating system for all or substantially all of a building;

(d) exterior painting or replacement of siding on all or substantially all of a building; and

(e) repairs reasonably related to correcting and/or preventing the spread of defects which are noted as findings in a Wood Destroying Pest and Organisms Inspection Report issued by a pest control company registered in Branch 3 of the State of California Structural Pest Control Board provided that any expenditure for such repairs exceeds the lesser of $6,000 or the product of $1,000 times the number of units in the property.

(3) In determining the cost of a major repair under this subsection, no consideration shall be given to any additional cost incurred for increased property damage and/or deterioration resulting from an unreasonable delay in the undertaking or completion of any repair or improvement.

(4) Any rent increase granted for a major repair item under subsection (E) shall be subtracted from any rent increase subsequently granted under this subsection for the replacement or renovation of the same item.

(5) Notwithstanding the foregoing, the monthly sum of all rent ceiling increases awarded under subsection (E)(1)shall, during the tenancy of any person described in subsection (E)(5), be no greater than $25. The portion of the rent increase awarded under this subsection may be increased by the Cost of Living Adjustment (COLA) awarded annually by the State Legislature to Supplemental Security Income (SSI) recipients in California, provided, however, that in no case shall the COLA adjusted rent increase exceed the total monthly increase granted under subsection (E)(1).

(a) Any tenant over the age of 62 whose household income does not exceed 30% of the Oakland PMSA median income of a household of the same size, as estimated by HUD annually; or 150% of the total SSI payment (i.e. federal and state components) in California, effective January 1, 1996, adjusted by the COLA, for a person or persons living in their own household; whichever is more for a household of the same size.

(b) Any tenant receiving general assistance pursuant to California Welfare & Institutions Code sections 17000 et seq., Aid to Families with Dependent Children or any successor program, Supplemental Security Income or Social Security Disability Insurance.

(6) As used in the following sections of this Regulation 1267, the term capital improvement shall be read to include major long-term repairs.

(F) Future Improvements

A landlord may petition for rent adjustments based upon the anticipated cost of a capital improvement to be completed within two years of the date the petition is filed. If approved, the rent adjustments shall not take effect until the completion and actual cost of the improvement is documented to the Board. Within 30 days of submission of the documentation, the rent adjustments shall be granted administratively unless (1) the tenant files an objection which requires a hearing or (2) the Hearing Examiner requests additional evidence or testimony because the actual costs significantly exceed the anticipated costs. Rent adjustments authorized under this subsection on or after January 1, 1999 shall be implemented in accordance with the terms of subsection (I) and shall be allocated in accordance with the rent ceilings in effect when the documentation of completion and cost is submitted to the Board.

(G) Petition Procedure

(1) Petitions. A landlord requesting rent adjustments for capital improvements only shall file a petition and two copies of the supporting documentation with the Board and shall submit one copy of the completed petition and a postage paid, addressed envelope for each unit affected by the petition. Within fifteen (15) days of the filing of the petition, Board staff shall review the petition and supporting documentation for completeness and conformance to Board regulations and either mail notice of the petition's unacceptability to the landlord or, if the petition is acceptable, mail the petition to the tenants in compliance with subsection (F)(2). The notice of a petition's unacceptability shall specify the defect or deficiency and state that the landlord may cure the defect or deficiency within thirty (30) days or the petition will be dismissed.

(2) Supporting Documentation.

(a) The supporting documentation must substantiate the nature and cost of the claimed improvement and may include copies of invoices, signed contracts, material and labor receipts, self labor logs, proof of entitlement to skilled labor rate (if claimed), canceled checks or any other items of documentation accepted and used in the normal course of business. Reports which merely summarize or refer to undocumented expenditures are not, by themselves, adequate substantiation. Hearing Examiners shall weigh and evaluate the nature of the documentation submitted as substantiation, and may require additional proof. Evidence of compliance with applicable permit requirements and correction of any cited code violations may also be required.

(b) If a hearing is held on the petition, tenants may subpoena additional evidence if the submitted documentation is inadequate. One copy of the supporting documentation shall be available for inspection at the Board. The landlord shall also provide the supporting documentation to any tenant who requests it within five (5) days of the request; however, if the petition is approved, in whole or in part, the landlord may recover the cost of duplicating the documentation, at the rate of $0.05 per page, from the tenant as a temporary rent increase. In addition, for properties containing sixteen (16) or more units, the landlord shall make the supporting documentation available for reasonable inspection by the tenants at a designated unit located at the property. "Reasonable inspection" shall include the right to remove the documentation from the designated unit for up to twenty four (24) hours for review in private and copying by tenants.

(3) Notice to Tenants. Within fifteen (15) days of the filing of an acceptable petition, the Board shall mail to all affected tenants a copy of the petition, a notice of the tenants' right to object to the petition listing the possible grounds for objection and a rent adjustment analysis (RAA) indicating the amount of rent increases which would be authorized for each affected unit if the petition were approved as submitted. The notice shall further state that if the tenant does not file an objection on any of the possible grounds for objection listed in subsection (H)(4) within thirty (30) days of the mailing of the notice, the tenant will be deemed to have waived his or her right to a hearing and that the rent for the tenant's unit may be increased by the appropriate amount based on the landlord's petition and the Board's files. A copy of the RAA shall also be sent to the landlord. A proof of service stating the date and place of mailing of each petition, notice and RAA shall be retained in the petition file.

(4) Grounds for Tenant Objection. Tenants subject to petitions under subsection (G)(1) may file objections with the Board within thirty (30) days of the mailing of the petition and notice of right to object to the tenants. Failure to file an objection on any ground specified in this subsection shall constitute a waiver of the right to a hearing on the petition. Such objections must be made on one or more of the following grounds:

(a) The increases set forth in the RAA are inaccurate;

(b) One or more of the improvements is actually repair or maintenance or does not have a useful life of more than one year;

(c) One or more of the improvements has a direct cost of less than $1,500.00 and less than $200.00 per affected unit;

(d) Some or all of the work alleged to have been performed has not been performed;

(e) The costs claimed for one or more of the improvements are not true or reasonable or are unsubstantiated;

(f) The landlord has recouped the cost of one or more of the improvements through a prior petition;

(g) One or more of the improvements is unnecessary to comply with applicable code requirements, is not reasonably necessary for the proper maintenance of the property or the correction of defects described in Subsection (E)(2), does not improve the seismic safety of the rental property, does not significantly increase the energy efficiency of the property, or is not provided by the landlord in good faith to primarily benefit the tenants;

(h) Some or all of the cost of an improvement is attributable to the landlord's negligence or to an unreasonable delay in the undertaking or completion of the improvement;

(i) Some or all of the cost of the improvement was paid for with proceeds from an insurance policy covering the property;

(j) The landlord has claimed an inappropriate self labor rate;

(k) The landlord did not make the supporting documentation reasonably available to the tenant;

(l) The work was not done in compliance with applicable permit and/or code requirements;

(m) The unit is not eligible to receive annual general adjustments for any period since its rent was last certified or individually adjusted by the Board. Any such objection shall identify each challenged annual general adjustment and the reason for the alleged ineligibility;

(n) The landlord is collecting rent in excess of the lawful rent ceiling;

(o) The unit is substantially deteriorated, fails to comply substantially with applicable state rental housing laws or local housing, building, health and safety codes, or the landlord does not currently provide adequate housing services;

(p) The capital improvement was completed prior to or commenced within one year after the establishment of an initial rent on or after January 1, 1999;

(q) The rent adjustment allocable to my rental unit for the capital improvement should be decreased because there have been vacancy increases imposed on this rental unit on or after January 1, 1999;

(r) The rent adjustment allocable to my rental unit for the capital improvement should be decreased because there have been vacancy increases imposed on other rental units at the property on or after January 1, 1999 and the vacancy increases exceed the amount of the capital improvement adjustment allocable to those units; or

(s) The tenant believes in good faith that the landlord is not entitled to a rent increase for some other substantive reason.

(5) Rent Increases. Within thirty (30) days of the termination of the period for objecting, specified in subsection (F)(4), or of the filing of express written waivers of the right to a hearing signed by all affected tenants, whichever is sooner, the Board shall take one of the following courses of action:

(a) For any property where no tenant timely objects on a ground listed in subsection (F)(4), and where the evidence submitted supports the assertions in the petition and substantially conforms to the records of the Board, the Board shall issue a decision increasing the lawful rent ceiling in accordance with the petition, supporting documentation and the Board's records;

(b) For any property where no tenant files a timely objection, but where the evidence submitted does not support the assertions in the petition or information in the petition does not substantially conform to the records of the Board, the Board shall notify the landlord of the defect or discrepancy and that, unless the petitioner cures the defect or requests a hearing within thirty (30) days of receiving notice of the defect, the Board shall issue a decision in conformance with the evidence. Any landlord response must be served on the affected tenants, who may thereafter reassert their right to a hearing within twenty (20) days of the service of the response. If the landlord submits a response to the Board's notice of defect and no hearing is requested, the Board shall issue a decision on the petition within thirty (30) days of the receipt of the landlord's response;

(c) For any property where a tenant objects, the Board shall set the petition for an individual rent adjustment hearing and so notify the landlord and tenants pursuant to Regulation 1223. Individual rent adjustment hearings pursuant to this regulation may be consolidated with hearings on other issues concerning the same units.

(6) Individual rent adjustment determinations under this subsection (F) shall be based only on the issues raised by the petition and the specific objections made pursuant to subsection (F)(4). Where an objection is found to be valid in whole or in part, the rent increase authorized under this regulation shall be reduced, denied or deferred, as the hearing examiner or Board determines to be appropriate. Any increase which is deferred due to a valid tenant objection shall be made effective upon submission of proof of compliance, subject to Regulation 1250. Where the only objections are found to be frivolous or made solely for the purpose of delay, the hearing examiner shall order the tenant making such objections to pay to the petitioner 50% of the petitioner's filing fee pursuant to Regulation 1247.

(H) Applicability

This regulation shall not be applicable to petitions properly filed with the Rent Board pursuant to Regulation 1207 before August 12, 1995; it will, however, apply to all petitions filed on or after August 12, 1995. The changes adopted by the Board on June 17, 1996 shall be deemed extinguished, null and void effective on June 17, 1996 if any bill passes in the State Legislature which occupies any part of the subject matter area of this regulation. The changes adopted herein are intended to establish the long term policy of the Board on capital improvement increases and are intended to remain in effect until December 31, 1998, at a minimum.

(I) Limit on Rent Adjustments After January 1, 1999.

(1) No rent adjustment pursuant to this regulation shall be granted in consideration of any capital improvement to a rental unit that had an initial rent established on or after January 1, 1999 if the capital improvement was completed before the establishment of the initial rent or completed or commenced within one year thereafter, except for a qualifying capital improvement that was not reasonably foreseeable at the time the initial rent was established.

(2) An upward rent adjustment authorized by this regulation that is allocable to a rental unit that has had one or more vacancy increases shall be decreased by the aggregate amount of such vacancy increases, except for work completed to achieve compliance with Berkeley's seismic retrofit and soft-story ordinances (Berkeley Municipal Code Chapters 19.38 and 19.39) as provided in subsections (2)(a)-(d), below:

(a) Work that is timely performed in accordance with the requirements of the seismic retrofit and soft-story ordinances (Berkeley Municipal Code Chapters 19.38 and 19.39) shall not be subject to vacancy increase offsets otherwise set forth in this subsection (2). Work completed before issuance of a second notice informing the owner of non-compliance with Chapters 19.38 or 19.39 shall be deemed timely.

(b) Incidental work not explicitly required by Chapters 19.38 or 19.39 shall not be subject to vacancy increase offsets only if such work has been mandated by the City as part of the permitting process for work required by Chapters 19.38 or 19.39 and not as the result of outstanding code violations. "Incidental work" for purposes of this subsection shall include any work that an appropriately licensed professional certifies is necessary to enable access for work required by either Chapter 19.38 or 19.39, permits such work to be accomplished at a commercially reasonable price, or restores or replaces an area damaged or required to be removed as part of completing work required by either Chapter 19.38 or 19.39.

(c) The exception created by this Subsection (I)(2) (a) and (b) shall be available to any petitioners whose ownership interest pre-dates the enactment of the applicable requirements, which is as of December 12, 2000 for work required by Chapter 19.38 or as of December 5, 2013 for work required by Chapter 19.39 .

(d) The exception created by this Subsection (I)(2) (a) and (b) shall not be available to any owners who hold more than a ten percent (10%) interest in any form whatsoever in more than a total of 12 residential units in Berkeley.

(3) To the extent that a particular rental unit's vacancy increases exceed the amount of the rent adjustment authorized by this regulation that is allocable to that unit at the time of decision, the excess shall be applied to reduce equally the rent adjustments otherwise allocable to other units at the subject property. For any unit that is vacant at the time of decision, vacancy increases shall be computed by using the most recent initial rent taking effect after December 31, 1998. This paragraph shall not apply to any unit or building to which the exception described above in subsections (I)(2)(a)-(I)(2)(b) above also applies.

(4) For the purpose of this regulation:

(a) The term "initial rent" means the rent established after a qualifying vacancy within the meaning of the Costa-Hawkins Rental Housing Act.

(b) The term "vacancy increase" means the increase in rent above the rent ceiling otherwise permitted by the Rent Ordinance that is obtained when an initial rent is established on or after January 1, 1999 under the Costa-Hawkins Rental Housing Act.

(c) A capital improvement is "commenced" when a contract is entered into for the performance of the capital improvement, when any supplies to perform the work are purchased or when any of the work is actually performed.