



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Jacky Morales-Ferrand

**SUBJECT:** SEE BELOW

**DATE:** April 29, 2016

Approved

*D. D. SyL*

Date

*4/29/16*

**SUBJECT: INTERIM APARTMENT RENT ORDINANCE RELATED TO  
TEMPORARY ALLOWABLE RENT INCREASES AND COST PASS-  
THROUGH PROVISIONS**

## RECOMMENDATION

Amend Chapter 17.23 of Title 17 of the San José Municipal Code providing an interim reduction in annual rent increases to 5%, establishing a deadline for cost pass-through petition filing under the current Apartment Rent Ordinance, and providing an interim fair return petition process, effective until January 1, 2017 or sixty days after the effective date of an Ordinance amending Chapter 17.23 consistent with Council direction, either by:

- (1) Adopting an urgency ordinance adding Part 8 to Chapter 17.23 of Title 17 of the San José Municipal Code; or
- (2) Adopting an ordinance adding Part 8 to Chapter 17.23 of Title 17 of the San José Municipal Code.

## OUTCOME

The adoption of an Interim Apartment Rent Ordinance (Interim Ordinance) would provide temporary requirements that owners of apartments under the Apartment Rent Ordinance must follow. These interim provisions include an interim limit on rent increases to 5%, a deadline for filing and award of petitions, a fair return process, procedures and effective date, and the termination date of the interim ordinance. As part of this action, the City Council will determine if the Interim Ordinance is adopted either as (1) an urgency ordinance effective upon adoption or (2) a non-urgency ordinance, which would make it effective 30 days after the second reading.

## **BACKGROUND**

On April 19, 2016, the City Council considered changes to the City's Apartment Rent Ordinance (ARO). After extensive discussion and public comment, the Council approved several modifications to the ARO, including lowering the allowable annual rent increase from 8% to 5%, eliminating the debt-service pass-through provision, implementing a rent registry, and creating an Anti-Retaliation & Protection Ordinance. The City Council also directed staff to bring back for Council consideration an urgency ordinance that provides a temporary pause in rent increases to tenants occupying apartments covered by the ARO. This urgency ordinance memorandum was not previously published and public testimony has not yet been heard. It is therefore separate from the ARO-related issues that were continued from the April 19, 2016 City Council meeting (item 4.1) for Council consideration to the May 10, 2016 Council meeting (item 4.4).

## **ANALYSIS**

As mentioned, the urgency ordinance that staff was directed to bring to City Council for their consideration, was to include a temporary pause in all rent increases for ARO apartments. However, instead of a temporary freeze on all rent increases, staff recommends a less restrictive interim ordinance allowing 5% annual rent increases and permitting rent increases from pass-throughs per the current ordinance, until September 1, 2016. The Interim Ordinance would terminate no later than January 1, 2017.

### *Need for an Interim Ordinance*

The Interim Ordinance will allow some features of the Council recommendations, such as the rent increase reduction and elimination of the debt service pass through, to be implemented earlier than the date by which a comprehensive ordinance will be ready. An interim ordinance will also aid the transition to the new ARO provisions requested by Council. Staff will need time to prepare the new procedures and petition forms pertaining to the permanent modifications to the ARO (including fair return petition forms). Per the ARO, the forms need to be reviewed by the Housing and Community Development Commission. In addition, staff needs time to update program information and FAQs, inform tenants and landlords of the modifications, and train hearing officers on the new fair return procedures.

### *Key Provisions of Interim Ordinance*

The interim ordinance would add a new Part 8 to Chapter 17.23, Title 17, of the San José Municipal Code that contains provisions (effective until January 1, 2017 or sixty days after the effective of an Ordinance amending Chapter 17.23, whichever is earlier) that reduce the allowed annual rent increase to 5%, prohibit pass-through petitions under the current ordinance after September 1, 2016, and add a new fair return petition process effective after September 1, 2016.

It would provide owners the ability to increase rents up to 5% for in-place tenants provided that rents have not been increased in the previous 12-months. If a tenant voluntarily vacates a unit, owners may reset initial rents for the new tenant (i.e., vacancy decontrol is permitted). Rent increases available through the pass-through provisions provided under the current ARO – including debt-service, capital improvement, rehabilitation, and operations & maintenance – will be prohibited after September 1, 2016. Rent increases based on eligible petitions filed between the effective date of the interim ordinance and September 1, 2016 shall not include any increase in excess of approved reasonable cost pass-throughs plus, for capital improvements, no more than two percent (2%) of the monthly rent. (Under the current ARO, capital pass-throughs include eligible cost pass through plus 5% of the monthly rent.) It is anticipated that the capital improvement petitions that miss the September 1 deadline can be processed under the expedited process provided in the modified ARO.

After September 1, 2016, landlords may still petition for a rent increase in excess of the 5% increase allowed, using the fair return process. The fair return petition process is to ensure that landlords will have the opportunity to petition if they believe they are not getting a fair return, based on net operating income received by landlords in 2014 (i.e., the “base year”) adjusted for inflation as measured by the Consumer Price Index, San Francisco Bay Area-All Urban Consumers. A fair return petition must be filed on a City-approved form and must include copies of all documents and information on which the landlord relies to establish that the base year net operating income was unusually low. The information would be considered by a hearing officer through an arbitration hearing.

The interim ordinance will terminate on the earlier of: 1) sixty days after the effective date of an ordinance amending Chapter 17.23 to decrease the annual allowable rent increase to five percent (5%), to revise the cost pass-through process, and to require registration of rents or units, or 2) January 1, 2017.

#### *The Urgency Ordinance and Non-Urgency Interim Ordinance*

Two forms of the interim ordinance are being presented for Council Consideration: 1) a regular ordinance (non-urgency) that can be adopted by majority vote; and 2) an urgency ordinance, which under Section 605 (d) of the San José City Charter, requires eight affirmative votes and a finding that it is an urgency measure necessary for the immediate preservation of the public peace, health or safety, containing a statement of the facts constituting such urgency.

An urgency ordinance would be effective immediately, while a non-urgency ordinance would require a second reading and a 30-day period after the second reading before it becomes effective.

#### *Findings and Supporting Facts for Urgency Ordinance*

Given the high cost of housing in San José and the concerns of regarding immediate health and safety impacts to renters as described below, staff have also prepared an urgency ordinance for

Council consideration. The following is a summary of staff's findings and the facts in support of the findings:

- Displacement through evictions and significant rent increases destabilize the living situation of renters in ARO apartments, has a direct impact on the health of San José's citizens by uprooting children from their schools, disrupting social ties and networks that are integral to citizens' welfare and the stability of communities, and creates undue hardship for low-income residents through additional relocation costs, stress and anxiety, and the threat of homelessness due to lack of alternative housing options.
- In recent months the City Administration has received an increasing number of calls from tenants of ARO apartments regarding actual and potential increases in rents up to and above the current annual maximum of 8%, inquiries regarding two increases in a single year, as well as calls from tenants who have received no-cause evictions.
- Since the April 1, 2016 City Council meeting, staff have received several inquiries by phone and email from owners about how to maximize rent increases in ARO apartments in order to achieve market rents, as well as the timing of when the reduced allowable rent increases would become effective and whether they could still raise rents according to current ARO provisions. Staff have also received several inquiries by phone and email about potential purchases of ARO apartments and debt-service pass-throughs. Such pass-throughs have led to significant rent increases for tenants of ARO apartments.
- The Apartment Rent Ordinance impacts a sizeable number of renters living in rent-stabilized apartments. Currently, there are approximately 44,300 rent-stabilized apartments ("ARO apartments"), comprising roughly one-third of the City's rental housing stock and housing approximately 11 percent of San José residents.
- The City of San José has long been one of the most expensive cities in the country in which to live. San José continues to have a severe housing affordability crisis, with one of the highest rates of rent increases in the nation. In March 2016 the median rental price for a one-bedroom apartment in San José was \$2,244 per month (\$26,928 per year), a 9 percent increase in costs over March 2015, and the median rental price for a two-bedroom apartment was \$2,792 per month (\$33,504 per year), a 7.3 percent increase over costs in March 2015.
- The March 2016 report written by Economic Roundtable found that rents in ARO apartments rose faster than market-rate rents (111% increase versus 105% increase, respectively) during the time period from 1990 to 2014.
- In 2014 (latest available Census data), the estimated annual median household income for households that rented ARO apartments in San José was \$39,000, \$8,000 less than the median income for renters in non-ARO apartments.

- Affordable rent, defined as spending no more than thirty percent of income on housing, for a household earning \$39,000 is approximately \$975 per month. In 2014 the median rent for an ARO apartment was approximately \$1,308, which would require an annual income of over \$52,000 to be considered affordable.
- Real (inflation-adjusted) rents for ARO apartments have increased between 1990 and 2014 while real (inflation-adjusted) incomes for ARO renters have decreased during the same time period.

### **EVALUATION AND FOLLOW-UP**

If the City Council adopts the urgency interim ordinance, it would become effective immediately and would not require a second reading and follow-up with the City Council. If the Council adopts a non-urgency interim ordinance, staff would return to the City Council for a second reading.

### **POLICY ALTERNATIVES**

As indicated above, staff has provided the City Council an urgency interim ordinance and a non-urgency interim ordinance for consideration. Both options would provide the time necessary for staff to transition the current ARO program to the modified ARO. Both options also establish temporary requirements for owners of ARO apartments to follow during this transition period. The difference between the urgency versus the non-urgency ordinance is the timing of when they would be effective. The content and requirements are the same for both alternatives.

### **PUBLIC OUTREACH**

This recommendation for an interim ordinance is in response to the City Council's direction during the April 19, 2016 on modifications to the ARO for staff to return with an urgency ordinance. It is estimated that over 500 individuals attended the April 19 Council meeting. Prior to that Council meeting, a significant public process was held, including 11 meetings with the ARO Advisory Committee, three general public meetings, and two public meetings at the Housing and Community Development Commission, to receive input on potential modifications to the ARO.

### **COORDINATION**

This memorandum has been coordinated with the City Attorney's Office and the City Manager's Budget Office.

HONORABLE MAYOR AND CITY COUNCIL

April 29, 2016

**Subject: Interim Apartment Rent Ordinance Allowable Rent Increase and Pass-Through Provisions**

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**CEQA**

Exempt, Section 15061(b)(3) No potential for causing a significant effect on the environment.  
File No. PP16-051.

/s/

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Director, Department of Housing

For questions, please contact Wayne Chen, Acting Division Manager, at (408) 975-4442.