**COUNCIL AGENDA:** 1-31-17
**ITEM:** 4.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

# Memorandum

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| **TO:** | HONORABLE MAYOR AND CITY COUNCIL | **FROM:** | Councilmember Donald Rocha |
| **SUBJECT:** | **APARTMENT RENT ORDINANCE** | **DATE:** | January 27, 2017 |

Approved Don Rocha PH Date 1-27-17

## RECOMMENDATION

Accept the audit of the Apartment Rent Ordinance and take the following additional action:

1. Direct staff to implement audit recommendation #12, which would eliminate the banking provisions in the final ordinance.

2. Direct staff to bring back an item for Council consideration that would expand the rent control program to all duplexes that could potentially be covered by it.

## ANALYSIS

Last Spring, the City Council provided staff direction on modifying the Apartment Rent Ordinance. The Council majority rejected the staff recommendation (which I supported—see the attached memo) and instead decided to adopt a more lax standard. They reduced the annual allowable increase to 5% (it had been at 8%), but they also allowed landlords to bank any unused portion of that 5% (which they weren't allowed to do when the increase was at 8%.) Under the new system, the Council directed that landlords be allowed to bank up to a 10% increase, and be able to use up to 3% of their bank in any given year, which would result in a maximum yearly increase of 8% (5% yearly increase plus 3% from the bank.)

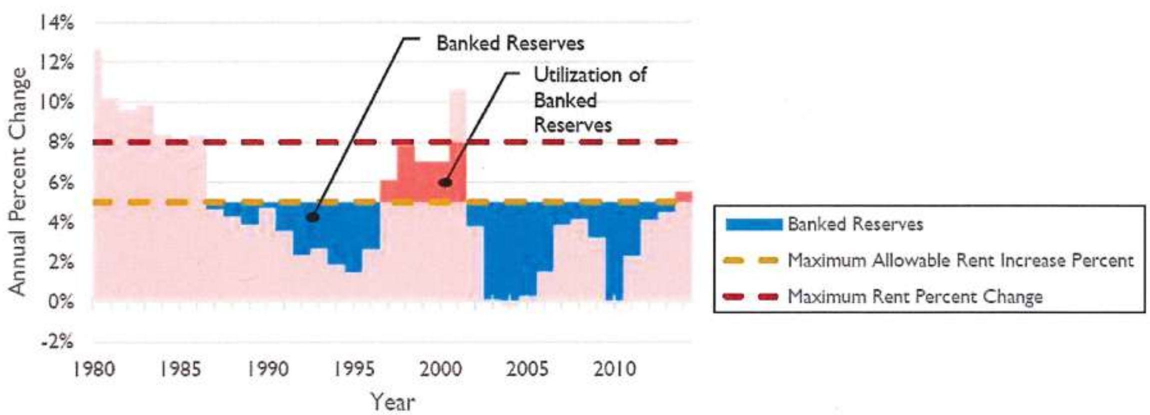
I greatly appreciate the Auditor's efforts in reviewing the Rent Ordinance, including the above direction from the City Council. It's always useful to have someone else check the work that the Council does. What the Auditor found was that the Council direction did have some shortcomings. In particular, she identifies the banking provision directed by the Council as problematic. Here's what she says on page 33 of the audit:

> Our modeling shows that the 5 percent limit on annual rent increases that was recently approved by the City Council, would protect tenants only from the most dramatic market spikes. Controlling these rent spikes may provide critical relief, however the accompanying banking provision allows for annual rent increase of up to 8 percent, which undermines the protections offered by the 5 percent limit.

At the time the Council directed staff to pursue the 5% with banking model, the decision was portrayed by some as a "compromise" that balanced the needs of tenants with the needs of landlords. I disagreed with that sentiment at the time, and with the benefit of the Auditor's analysis I think it should now be clear to everyone that the Council action was not a compromise and does not represent the interests of tenants. As the Auditor points out, the banking provision undermines tenant protections. With this memo I recommend that we heed the Auditor's good advice and eliminate the banking provisions to ensure that our ordinance is meaningful and effective.

Let's take a moment to review why the Auditor came to the conclusion that banking should be eliminated. Page 41 of the audit presents the below chart, which shows how the 5% with banking approach would have played out over the past few decades if it had been in place. The chart assumes that rent increases are consistent with CPI and that there is no vacancy decontrol.

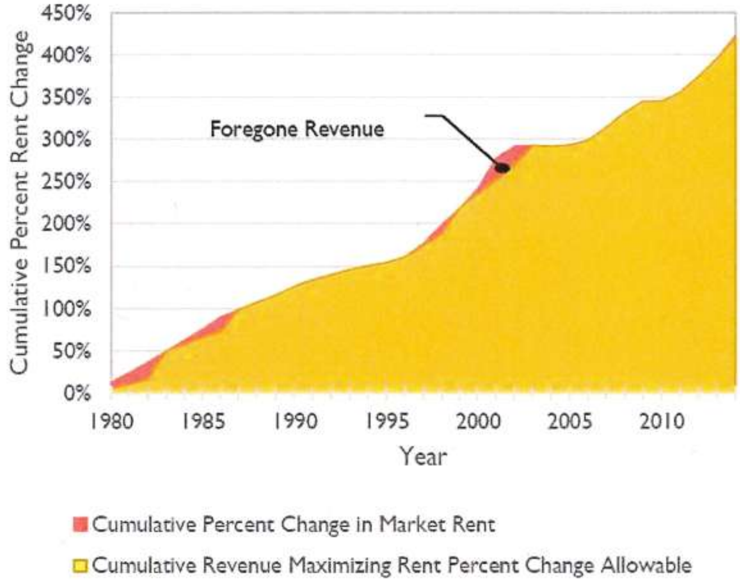
**Exhibit 17: Banking Would Allow Some Landlords to Charge Market Rates and Exceed the 5 Percent Limit During Market Spikes**




Under the above assumptions, the 5% with banking approach would only have constrained rent increases once in the past 15 years (as you can see, the 2001 increase extends above the red dotted line.) A rent ordinance with such a miniscule impact is not a "compromise" and does not respect the interests of tenants. Of course it's possible to change the assumptions used above—every individual landlord is in a different position—but on the whole the Auditor is very well justified in her conclusion that the banking portion of our ordinance would undermine tenant protections. The alternative recommended by the Auditor—5% per year with no baking—would still have had a limited effect over the past 15 years (see page 37 of the audit for the relevant graph) but unlike what the Council adopted, that approach could provide meaningful protection from the most dramatic market spikes.

What's more, the Auditor puts forward analysis showing that a 5% flat increase without banking would not unduly reduce landlord revenue. The below chart estimates how much revenue landlords with typical tenant turnover would have forgone over the past decade with a 5% cap. As the chart notes, the 5% cap would have "slightly" reduced revenues, but the reduction is small as a proportion of total revenues.

**Exhibit 15: A 5 Percent Rent Cap Would Have Slightly Affected Revenue for Long Term Landlords Seeing Typical Tenant Turnover Between 1980 and 2014**




Taken together, the Auditor's analysis shows that eliminating banking is necessary to ensure meaningful protections for tenants and, at the same time, would not likely have a large impact on landlord revenues. I believe this should be an easy decision for the Council. We should not find it acceptable to go from the previous rent ordinance, which was not effective in protecting tenants, to a new rent ordinance, which will also not be effective. The whole point of this exercise was to help protect folks who are vulnerable in our community, and I think we have an obligation to ensure that we achieve that goal—not just in appearance, but in reality.

I also make one other recommendation: that we direct staff to bring back the issue of including eligible duplexes under the rent ordinance. Currently the ordinance only applies to properties with three or more units. There are approximately 10,000 duplex units in the City that could potentially be covered by our rent ordinance, in comparison to approximately 44,000 units that are currently covered by our rent ordinance. 10,000 units would constitute a significant expansion. Our ability to expand rent stabilization protections is otherwise very limited. State law prevents us from expanding protections to newer units, while units that do fall under the ordinance are being lost to redevelopment as we saw with approval of The Reserve last year. Adding duplexes is one of our only opportunities to expand rent stabilization protections. Given the great need for such protections in our community I believe we need to pursue that opportunity. If the Council directs staff to come back with this issue, my hope would be that staff could do the necessary analysis and outreach before returning to Council to allow the Council to act on this matter.

I thank my colleagues for their thoughtful consideration, the Auditor for her good work on this item, and Housing staff for all of their work on the rent ordinance over the past year.

# Attachment: April 2016 memo

**COUNCIL AGENDA:** 4-19-16
**ITEM:** 4.1

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

*Memorandum*

| | | | |
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| **TO:** | HONORABLE MAYOR AND CITY COUNCIL | **FROM:** | Councilmember Donald Rocha |
| **SUBJECT:** | **APARTMENT RENT ORDINANCE** | **DATE:** | April 14, 2016 |

Approved Don Rocha Date 4/14/16

## RECOMMENDATION

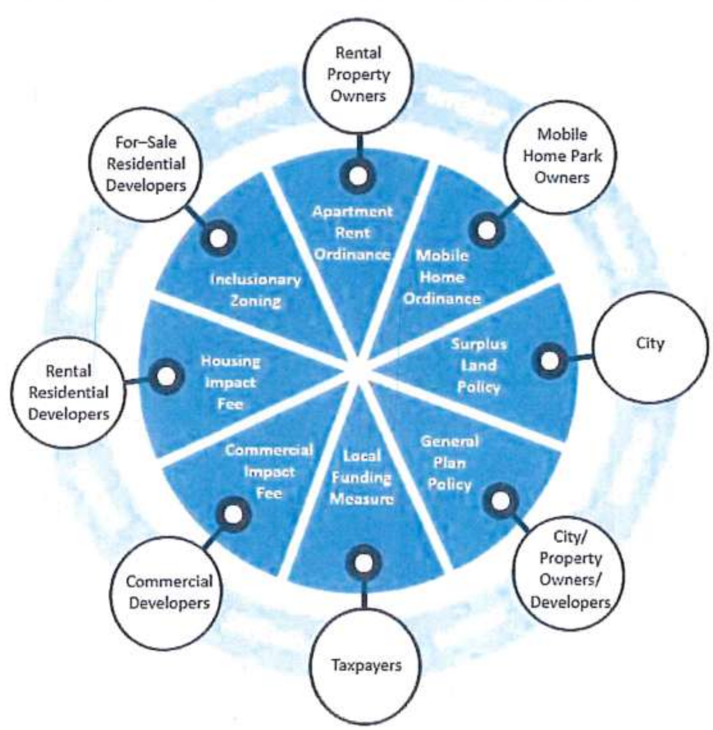
1. Approve the staff recommendation for modifications to the Apartment Rent Ordinance with the following amendments:
   a. **Duplexes:** Direct staff to bring the issue of whether or not duplexes should be included under the Apartment Rent Ordinance back to City Council for further consideration after having conducted any additional work that may be needed to fully vet the issue, such as an evaluation of the time and staffing that may be needed for implementation, any additional analysis of the effects of including duplexes under the ordinance as may be possible, and any additional outreach as may be necessary.
   b. **Displacement:** Approve staff recommendations 8, 9, and 10, which recommend further ordinance development around displacement issues, and provide additional direction for staff to analyze the proposed displacement ordinance outlined in recommendation 8 of Councilmember Jones' memo dated April 8, in addition to any other policy options staff or Council may wish to recommend.
   c. **Maximum Allowable Rent Methodology:** Use a maximum allowable rent methodology instead of a banking methodology to track unused rent increase capacity. The maximum allowable rent methodology would set a maximum allowable rent for each unit based on the base year rent, plus the accrued maximum allowable increases for all subsequent years. Landlords would be allowed to charge up to the maximum allowable rent, provided that rent increases each year are consistent with the 8% ceiling proposed in the staff recommendation. This method achieves the same outcome as the banking methodology in an administratively simpler fashion, as it eliminates the need to track how much the landlord has banked for each unit.
   d. **Outreach:** As part of implementation of the Anti-Retaliations & Protection Ordinance, direct staff to conduct outreach in multiple langues to educate tenants about their rights under the ordinance, with particular attention to groups that may be most vulnerable to abuse, such as immigrant communities.

2. Direct staff to return to Council in 18 months with an update on implementation of the Apartment Rent Ordinance. As part of this update, staff should provide the Council with any data they may have collected on no-cause evections through implementation of the Apartment Rent Ordinance, and should assess whether the Rent Ordinance is effective in the abscense of a good cause eviction ordinance.
3. Request that either staff or the Rules Committee agendize a Council item for the May 3, 2016 council meeting for the purpose of allowing the Council to direct staff to conduct a nexus study and feasibility study for a commercial impact fee in San Jose.

**ANALYSIS**

The high cost of housing is causing great suffering in San Jose. From the young professional who can't afford to buy a house, to the homeless person living along a freeway, to the parent who gives up time with her child to work a second job, to a retiree worrying about the next rent increase, our residents feel the pain of the housing crisis every day. It threatens their economic stability, forces them into overcrowded housing, prevents them from saving for the future, and in some cases threatens their health and ability to survive. In my opinion, the housing crisis is the single most serious problem we face in San Jose; it has dire consequences for thousands upon thousands of people. With this memo, I propose to address this crisis by not only approving modifications to the Apartment Rent Ordinance, but also by asking that the commercial impact fee be brought back to Council so that we can direct staff to study that issue.

I feel strongly that we need to pursue both the amendments to the Rent Ordinance as recommended by staff and the commercial impact fee because no one strategy is enough to solve the housing crisis on it own; the only way we can make significant progress is to pursue every strategy available to us. Most of these strategies impact an engaged constituency—the housing impact fee affects residential developers, the commercial impact fee affects commercial developers, the Apartment Rent Ordinance affects rental property owners—but the only fair and effective way to deal with this problem is to ask that all parts of our community (including our voters, through a potential local funding measure) do their part to address the problem. The chart at right demonstrates how many different interests must all contribute to addressing the problem.

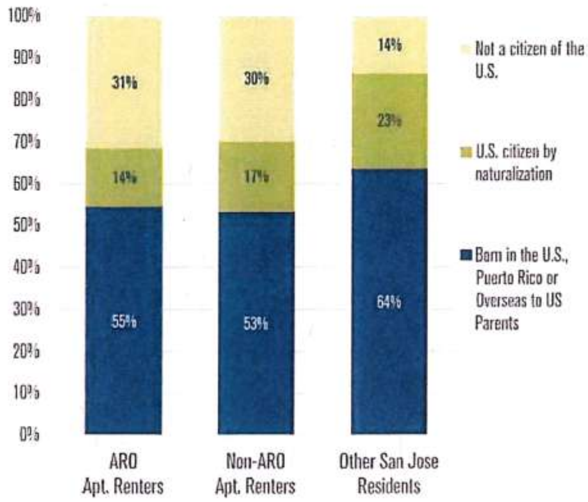


**Apartment Rent Ordinance**

Let me speak to the Apartment Rent Ordinance first, and then discuss the commercial impact fee. The Apartment Rent Ordinance is not a silver bullet—it won't expand our supply of housing, or even apply to all rental units within the city—but I do believe that it can make a difference for some renters. Our current rent ordinance can allow up to an 8% rent increase every 12 months and a 21% increase provided there has been no other increase for 24 months. In a hot rental market, large increases can disrupt the lives of renters, upending their personal finances and potentially forcing them to find a new home. Landlords have a right to a fair return on their property, but I also think the City has an interest in providing some measure of stability to those who rent. Thus, I recommend approval of the staff recommendation.

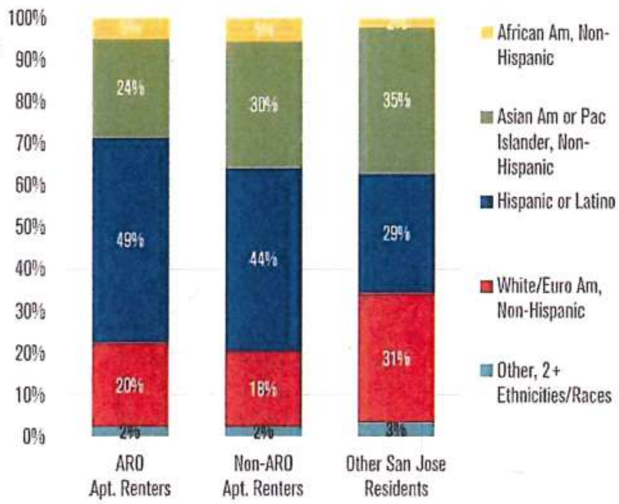
It may sometimes be difficult for those of us who own homes to fully appreciate the struggles that renters face. Property ownership can confer a degree of stability that renters simply do not enjoy. I believe we have an obligation to take the struggles of renters seriously, even if we do not experience those struggles ourselves. The Apartment Rent Ordinance Study shows that renters in San Jose are comprised of groups that tend to be most vulnerable and historically have had the least influence in City Hall. For example, the below charts (taken from the ARO Study) show that about a third of ARO renters are not citizens and about half are Hispanic.

Figure 3.14 – Citizenship Status of San José Renter Residents, by ARO status




Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of the CIT (Citizenship Status) variable. Universe: Total population.

Figure 3.6 – Race-Ethnicity of San José Renter Residents, by ARO status



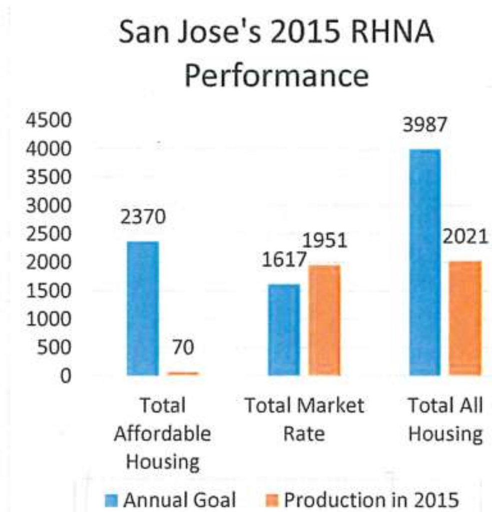

Source: Economic Roundtable analysis; U.S. Census Bureau, 2009-2013 5-Year American Community Survey, Public Use Microdata Sample (PUMS). Based upon recoding of RAC1P and HISP variables.

I also propose a few additions to the staff recommendation. First, I recommend further consideration of including duplexes under the ordinance, given that they represent around 11,000 additional units. Our current Rent Ordinance applies to only one slice of the rental market—the bigger we can make that slice the more stability we can provide for tenants. Second, I recommend directing staff to pursue displacement policies, and as part of that effort direct them to analyze the displacement program proposed by Councilmember Jones. I'm open to considering Councilmember Jone's proposal, but believe that in the interests of thoughtful policymaking we should allow staff to do additional work before making a final decision on which model to use. Third, instead of using an unlimited banking methodology, I propose that we simply establish a maximum allowable rent for each unit. This method would achieve the same outcome as unlimited banking, as proposed by staff, but would be administratively simpler as staff would not need to track how much is banked for each unit. Finally, I propose that we direct staff to conduct multilingual outreach to ensure renters are aware of their rights under our proposed anti-retaliation provisions.

**Commercial Impact Fee**

Last December, we had the opportunity to conduct both a nexus study and a feasibility study for a potential commercial impact fee, but the Council ended up declining to study the issue. Many points were made about the dire consequences of approving a commercial impact fee—it would kill commercial development, it would would harm the City's fiscal future. In my opinion, passing judgement on an idea before you even study it is a backwards approach to policymaking. The feasibility study proposed by staff back in December would have attempted to analyze the effect of a fee on the development market in San Jose. With that analysis we would have had a factual basis to make judgements about the consequences of a fee, instead of merely speculating from the dias. We might have learned that a relatively modest fee would have had little to no impact on development decisions. Given the great need, even a realtively small amount of money from a modest fee is worth purusing.

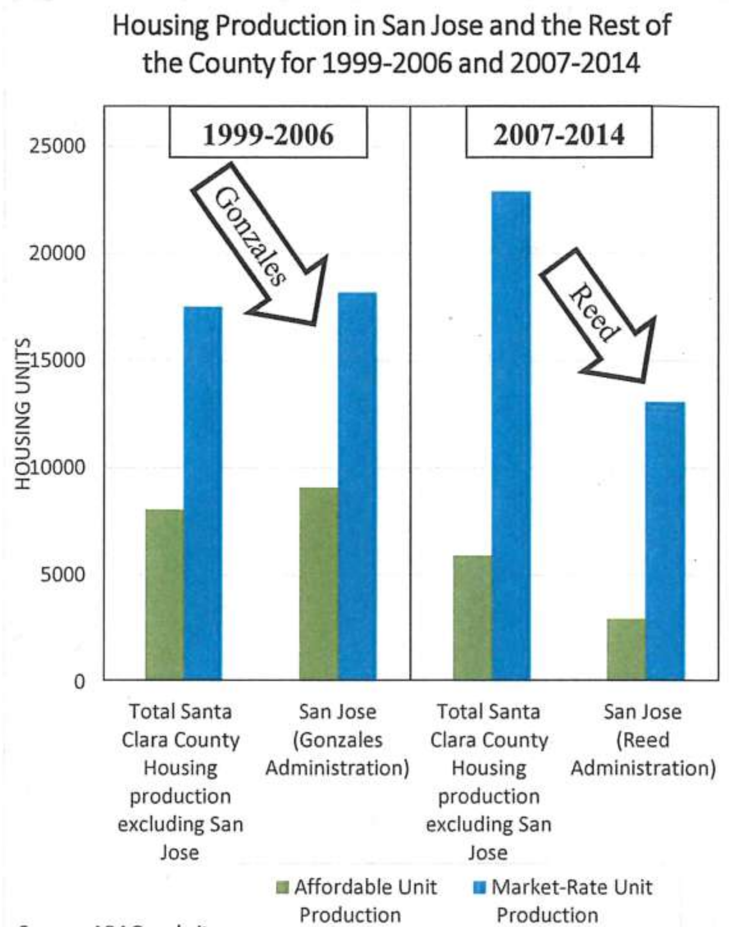
Even when inclusionary zoning and the housing impact fee are implemented, it's unlikely we will have adequate affordable housing funding to meet the need. According to Housing Department data, only 70 affordable housing units were built in San Jose during 2015, out of the 2,370 needed according to San Jose's Regional Housing Needs Allocation (RHNA). In my opinion, 70 out of 2,370 is a failing grade. We may do better when our housing fees start coming in, but getting all the way to 2,370 units per year is a very tall order. If we start taking potential funding sources off the table without even studying them, it will be very difficult to hit that target.




*Source: Staff report for item 4.3 on the 3-15-16 San Jose City Council Agenda*

Whenever the issue of RHNA allocations and housing production comes up, there's a tendency in San Jose to start pointing the finger of blame—principally at other cities who aren't doing their fair share to produce housing. It's possible to debate whether this blame is deserved. During Mayor Gonzales' administration San Jose built more housing than the rest of the County, but during Mayor Reed's administration we fell behind other cities, as the chart on the next page demonstrates. To be fair, the changes between the two adiminstrations have multiple explanations, some of which were under the City's direct control and some of which were not (the elimination of redevelopment, for example, was out of our control.)

The point I want to make here is that it really doesn't matter whether other cities are to blame. Yes, we all want them to do more, but we don't have control over policymaking in other cities. We do have control over what we do in our City to help our residents. At its core, pointing fingers and blaming other people is a way of saying "I'm not responsible," and justifying our failture to take action. The fact is, *we are responsible*. We are responsible for considering every option to address this problem, including the commercial impact fee.




*Source: ABAG website. http://abag.ca.gov/planning/housing/datasets.html#reports*

## Conclusion

I'd like to close by reiterating the importance of taking responsibility for this problem. It is hard to ask constituency after constituency to do more on affordable housing—whether it's residential developers, commercial developers, mobile home park owners, rental property owners, or taxpayers, it's always a tough conversation. What we can't do, however, is exempt any one group from pitching in. When we ask one group to help out, we have to be able to say that we've asked everyone else to do their part too.