

PARK WATCH

A LEGAL DEVELOPMENTS NEWSLETTER

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A COURTESY FOR OUR FRIENDS AND CLIENTS

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THIS NEWSLETTER CONVEYS GENERAL INFORMATION, NOT LEGAL ADVICE: CONSULT AN ATTORNEY BEFORE RELYING HEREON

\$100.00 INCREASE AND VACANCY DECONTROL NEGOTIATED UNDER RENT CONTROLS

*// A Small Park Reaches Agreement with
Tenant Committee and City in Lieu of
Administrative Hearings and Litigation.*

By: Terry R. Dowdall, Esq.

▲ Synopsis

A park owner (50 spaces) in the City of Glendora recently purchased Glenair Mobilehome Park and determined that a significant rent increase was required to obtain fair rents for property tax re-assessments and a fair rate of return.

A carefully prepared rent increase application with supporting data and rate of return analysis was prepared and filed. Based on hard work and full-day negotiating sessions over the course of a month, agreement was reached.

The success of the owner's plan was possible due to prudent strategy coupled with credibility: planning, attention to detail, rapport with City staff and residents, and working to address resident interests and concerns. Resulting cost savings to the owner include the avoidance of administrative hearings and, of ultimate concern, the burden of expense for attorneys, experts and litigation. We prove here that even a small park can obtain fair rent adjustments with a good plan.

"... the thrust of the initial management strategy was to focus substantial time and effort in the mediation and negotiation phase"

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- *Strategies for Rent Increases—Mediating Under Rent Control*

▲ Facts

This older 50 space Glenadora park is located in a quiet residential area, housing long time homeowners with few facilities. The park was acquired within the past two years at a fair price consistent with properties offered for sale in the Glendora area.

However, by financial standards, the sellers had only financially nursed the park along, forbearing from seeking rents based on general market conditions. As a result, the passage of a mobilehome park rent control law caught them by surprise and froze rents well below market. The sellers had not even provided for separate utility charges. The buyers of the park were also faced with a very significant property tax re-assessment.

In sum, the sellers of the park had not kept pace with the realities of mobilehome park operation, foregoing opportunities to modernize financial operations, management and hence diminishing the value of their property. By contrast, the buyers, as skilled park operators, evaluated the real economic worth of the investment and its potential, even assuming rent control. Seeking a fair rent, even given the small size of the park, was certainly prudent and necessary to promote the investors' interests.

The rent increase application was carefully, thoughtfully prepared. While experts were selected to prepare reports and testify, the thrust of the initial management strategy was to focus substantial time and effort in the mediation and negotiation phase of

the application process. Management worked with these offices to develop a game plan designed to produce an accord with the tenant group well before any administrative hearing procedures even became necessary.

The application included a financial showing of the park business status, a rate of return economic analysis drawn from past applications and hearing experiences, legal reasoning behind the proposed increase, and even certain proposed concessions to deal with potential tenant hardships.

▲ *Outside the Box*

Part of the initial strategy was to seek a *long term* rent schedule. *But the rent control ordinance did not provide the jurisdiction for an agreement exceeding one year.*

Since the owner's aim was to reach a *multi-year agreement (and avoid rent increase entanglements for several years)*, management proposed that the accord itself be isolated from the provisions of the ordinance, relying on state law allowing for long term leasing. And, use of a multi-year proposal prevented a deadlock and undue focus on just one hefty single-year proposal. Finally, a multi-year plan opened the door to consideration of other tenancy issues, including utility concerns, long term security, predictability and avoidance of annual rent disputes.

Sometimes, it helps to be "likeable."

▲ *Maximizing Game Field Advantage*

We know that rent controls never favor landlords; and the field of play is always slanted. So, management sought to develop a positive image and amiable working relationship with the residents and staff. In a negotiating context, it is very important to try to build psychological bridges and to create identification and mutuality of interest in the bargaining process. This "good will" enhances the likelihood of success in reaching a mutually acceptable agreement. Through several mediation sessions, the effect of the shared mediation experience also took hold. Growing personal familiarity underscored with credibility and candor smoothed the road to agreement. Sometimes, it helps to be "likeable."

By the same token, it is beneficial, I believe, that the owner *not* be present in mediation proceedings, but that the management agent act for ownership. It is best for the owner to be available by telephone, but not present. This prevents your opposition from "reading" the owner's reactions to the negotiations, and allows more flexibility in the negotiation process. Counsel's presence can add or detract; but in this case, delicately urging conciliation due to the harsh unpleasant alternatives for all, in a non-threatening but genuine and candid manner, proved

useful and credible—people seem to listen when a lawyer talks about actually *reducing* his workload.

It must be remembered that both sides realized that failure to successfully mediate meant costly and time-consuming administrative hearings, all which would eventually result in a large single year rent increase. Even with a slanted hearing process, any adverse decision, we cogently and dispassionately explained, would be successfully challenged due to the undeniable evidence of a right to a very significant increase.

We noted case law stating, for example, that "... a ten percent rate of return was proffered as the fair rate, and that was never assailed as improper ... uncontradicted expert testimony concerning comparable investments ... established a 10 percent minimum ... Even the City of Escondido uses a 10 percent rate as the proper rate...the City of Scotts Valley was challenged successfully when the owner was denied a rent increase based on 9 percent rate of return opinion."

We relied on unassailable law that the rent adjustment mechanism must take into account that a higher rate of return when the risk taken is greater than a passive investment; that the rate of return must be sufficient to attract new capital to the market and conversely avoid the flight of capital from the market; that a reasonable rate is concomitant with the enhanced risk of operation of real estate, compared to a passive investment. Considering the actual investment, a clear case in plain English was explained, not lectured.

The risk of the owner's success in an adversarial hearing process was a significant factor in keeping negotiations reasonable and productive.

▲ *Showing Your Hand*

Offering a reasonable multi-year accord was made against the background of well-presented data, clear authority and logical explanation.

One of the strategies behind seeking early resolution to the rent dispute was to present a strong, clear and thorough case *at the outset*. Significant time was devoted to presenting the facts and arguments in support of the rent increase application. We correctly reckoned that presenting *all* the bases for the increase at an early stage was superior to any advantage of awaiting presentation of the data until the last minute, as often the case in adversarial proceedings. Simply, a strong showing at the outset helped to level the playing field so bargaining was

from a position of strength.

And based on past experience and familiarity, the owner's legal presentation and application offered the advantage of avoiding costs for experts at the mediation stage. Of the several methods available to estimate the appropriately supported equity return rate, owner presented survey data by a national real estate research firm to show the required level of fair investment return. We discounted other less reliable methods including analysis of sales data (considered less reliable because the transactions are individual and projections are based on initial year projections). Other theories, we concluded, may or may not reflect a buyer's belief about future direction of the investment, or construction of a rate appropriate to real estate investment based on returns in other investment and making adjustments for growth, liquidity, and risk.

We showed that the proper measure of return is the equity dividend (or "equity dividend rate": rate of return to the equity component). That formula is this:

$$\text{NOI - Debt Service} = \text{Equity Dividend} / \text{Equity Investment} \\ = \text{Equity Dividend Rate}$$

The equity dividend is the cash flow to the owner from operations following the payment of the mortgage and other borrowed capital, but before the payment of income taxes. The range of equity dividend rates reported in the survey range from a low of 8.80% to a high of 17.90%. The mean of that particular sample is 12.90%. We stated that a 9 percent factor (which we used to proffer a fair rent increase) was actually *below* the expected equity return of any survey and market information.

Based on all the relevant factors, the appropriate equity dividend rate, or cash-on-cash return on equity, was expected to fall into a range higher than the 9 percent relied on for the application as well-supported by the data and analysis. The appropriate return on the current equity in the subject amounted, we argued, to well more than 9 percent.

In short, we stated that while the purpose of rent control is to control excessive rents, the requested rent increase in this instance, despite its size, permitted this efficient landlord just to pay all actual and reasonable expenses and receive a fair profit.

▲ *The Negotiations*

After two all day sessions for mediation (conducted on Saturdays no less), the parties reached a tentative agreement, now just approved by the residents by 2/3 vote.

▲ *The Agreement*

The agreement provides for a first year increase of approximately \$100.00. This is achieved by a \$73.00 per month increase, plus the break-out of utilities previously included in the rent.

A sale of a mobilehome results in an immediate increase in rent to the market level, which is about \$200.00 per month higher than existing pre-increase rent.

For 4 years thereafter, the increases per year will be 5 percent. In the year 2013, the parties have again agreed to meet to re-negotiate, and the park owner is obligated to place all tenants under this agreement, even though they do not actually sign the accord.

▲ *What Can We Learn*

This case must be contrasted against an industry context of bitter litigation between other owners and municipalities which has dragged on for several decades--a hallmark of rent disputes for my 3 decades of work fighting rent controls. *But a small park owner cannot justify costly litigation over rents.* However, working toward long-term resident agreement is possible for any park owner. Certainly, every owner should actively monitor and seek a just return. Still, many owners do not do so and operate at a subsistence level with below-market rents or paltry annual adjustments because: the park is small, there is no debt service, personal concern for residents, or other reasons. But subsidizing tenants is a misguided venture--the net result of so "entitling" your residents is to give them equity in a lease, vested rights they will tenaciously fight for and cling to; in a sense, such owners transfer property and wealth to the tenants -- instead of co-investors, family members and themselves.

We know that rent controls are here to stay. They are not unconstitutional per se; they are essentially invulnerable to court challenges based on the way they are drafted. *But not invulnerable as applied to a park owner.* I have written for at least 15 years, that the future of rent control litigation is pursuit of court relief from a bad agency decision; *after working within the system to obtain a maximum fair rent.* If a satisfactory result can be obtained by early mediation, no legal entanglement is required at all. A multi-year accord is inexpensive to achieve, bearing a high "cost-benefit" possibility for achieving a fair rent, as is proven in this case.

Please feel free to contact Terry R. Dowdall, Esq. For further details.