



DATE: November 10, 2020

TO: Mayor and City Council

FROM: Deputy City Manager

SUBJECT: Residential Rent Stabilization and Tenant Protections: Introduce an Ordinance Amending Chapter 12, Article 1 of the Hayward Municipal Code Relating to Residential Rent Stabilization and Tenant Protections to Modify the Rent Increase Threshold to the Annual Change in the Consumer Price Index (CPI) with a Maximum and Minimum

RECOMMENDATION

That Council considers a recommendation from the Homelessness-Housing Task Force (HHTF) to adopt an Ordinance amending Chapter 12, Article 1 of the Hayward Municipal Code lowering the rent increase threshold from 5% to the annual percent change of Consumer Price Index (CPI), but no lower than 2% and not to exceed 5%.

SUMMARY

On July 14, 2020, City Council directed staff to analyze alternative lower rent stabilization thresholds for HHTF consideration. Staff presented an analysis of four different threshold options to the HHTF on September 3, 2020.¹

The HHTF reviewed staff's analysis of the benefits and challenges of using 1) a fixed percentage threshold, as established in the City's current rent stabilization ordinance, and 2) a threshold based on an established economic index, including three different potential indices. Following public comment and discussion, the HHTF voted two to one to recommend lowering the threshold from a fixed 5% to 100% of the annual change in the area Consumer Price Index (CPI), with a ceiling of 5% and a floor of 2%. With a 5% ceiling and 2% floor, the threshold would always fall within the range of 2% to 5%, regardless of the annual change in CPI.

This report summarizes staff's evaluation of potential thresholds and the HHTF's recommendation. Should Council decide not to adopt the HHTF recommendation to lower the

¹ September 3, 2020, HHTF Staff Report and Materials:
<https://hayward.legistar.com/MeetingDetail.aspx?ID=761370&GUID=D60C2C6C-E382-4800-8A69-32CE0765CB8F&Options=info|&Search=>

threshold, the current threshold of 5% would be maintained. If Council approves the HHTF recommendation, staff proposes that the rent increase threshold would go into effect and change every January 1.

BACKGROUND

Current Rent Increase Threshold & Allowable Rent Increases

On June 18, 2019², Hayward City Council approved a new Residential Rent Stabilization and Tenant Protection Ordinance (RRSO) to mitigate displacement of Hayward residents. Among other important provisions, the new RRSO extended rent increase protections to all rental units permitted under State law. The RRSO created a Residential Rent Increase Threshold (see RRSO Section 12-1.05), which establishes that rent increases for covered rental units:³

- Can only be imposed once every 12 months
- Can be no more than 5% of the existing monthly rent absent other justifications described below.
- Are subject to the RRSO's rent dispute resolution process if the rent increase exceeds 5% of current rent, meaning that tenants can petition a rent increase of more than 5% to initiate a review of the increase.

In addition to the annual rent increase, the RRSO includes several provisions for when rent increases of more than 5% are allowable, including applying banked increases from years the tenant did not receive a rent increase, capital improvement pass throughs, and fair return increases. The RRSO also establishes an allowable utility pass-through.

HHTF Recommendation

Following Council direction to analyze alternative rent stabilization options, staff presented the HHTF with two options at the September 3, 2020, meeting, which are summarized in the Discussion section of this report. The HHTF received written comment and heard public comment during the meeting from property owners and tenants. Following public comments and HHTF member discussion, the HHTF voted 2 to 1 to recommend lowering the rent increase threshold using 100% of the annual change in CPI, with a ceiling and floor.

DISCUSSION

The following section summarizes the more detailed discussion section presented to the HHTF on September 3, 2020 and the HHTF decision.

² June 18, 2019 City Council Staff Report and Attachments:

<https://hayward.legistar.com/LegislationDetail.aspx?ID=3985848&GUID=52D1B678-D6BB-401A-AB3C-8990885C0CDD&Options=&Search=>

³ Covered rental units are all units except: single unit properties that are exempt due to state law; owner occupied properties with a legal accessory dwelling unit; affordable housing units with other rent controls; hospitals, care facilities, convalescent homes, and transitional housing; motels, hotels, inns, and boarding houses; and non-profit cooperative units owned or occupied by most of the owners

Hayward Renters

Staff presented the HHTF with analysis of American Community Survey (ACS) demographic and income data, demonstrating that Hayward renters are more likely to be low-income racial and ethnic minority groups with a higher housing cost burden compared to Hayward homeowners. Over half of Hayward renters are housing cost burdened, meaning they pay at least 30% of their income in rent. Further, 26% of all renters are severely housing cost burdened, meaning they pay at least 50% of their income in rent. The data show that, while renters' income has increased at a greater rate than homeowners in the most recently available data, the proportion of renters experiencing housing cost burden has stayed consistent.⁴ This suggests that housing affordability continues to be a real concern for Hayward renters, as any potential income gains are consumed by housing costs for over half of Hayward renters.

Rent Increase Threshold

As an anti-displacement strategy, rent stabilization policies can help keep renters, particularly those of color who are more likely to rent and to experience greater housing costs, in their homes, preserving existing housing and helping to prevent homelessness. A key component of a rent stabilization policy is the rent increase threshold. The threshold is intended to both protect a tenant from housing instability and a landlord's right to a fair return, which landlords are guaranteed by the State Constitution. Staff analyzed the following thresholds as potential ways to achieve both objectives:

1. A fixed-rate threshold like the 5% threshold in the City's current RRSO
2. A threshold aligned with an economic index, including
 - a. Consumer Price Index,
 - b. HUD Annual Adjustment Factors Index, or
 - c. Annual Median Income

The analysis of each potential threshold considered the City's fair return standard, as outlined in the RRSO. The RRSO fair return standard ensures that a landlord's net operating income (not including debt service or capital improvements) increases at least the same amount as the increase in CPI from 2018. When a landlord's increase in net operating income is less than the increase in CPI, the landlord is eligible to petition for a rent increase of more than 5%. As part of the analysis of potential stabilization thresholds, staff evaluated the likelihood of each option ensuring a fair return for landlords as required by State law.

Recommendation to the HHTF

⁴ Through written public comment, Hayward community members recommended analyzing Bay Area Equity Atlas (BAEA) data on income growth, citing BAEA data demonstrating that only the 90th percentile of Hayward renters have experienced income gains (<https://bayareaequityatlas.org/indicators/income-growth#/?geo=09000000000000055>). BAEA data on income growth are only available through 2015, compared to ACS data which are available through 2018. ACS data show significant income growth for renters in 2017 and 2018, which is not accounted for in the BAEA data. Staff recommend continuing to use the more recently available ACS data for this analysis but will reference BAEA data as appropriate in future analyses.

Staff analyzed four thresholds and presented the full analysis to the HHTF (see the September 3, 2020 Homeless Housing Task Force for the full analysis.⁵) Based on the analysis, staff recommended two of the four options to the HHTF:

1. **Maintain the current threshold as a fixed percentage at 5%.** Available data indicate that this option would maintain the City's current stabilization rates, as renters' average annual median income increases match both the average increase of those submitted to the City since the RRSO was passed and the CPI Rent Index. This option provides an approximation of long-term market appreciation and promotes clarity and predictability for both landlords and tenants and reduces potential confusion related to frequent policy changes.
2. **Implement a new threshold using 100% of the annual change in the CPI All Items metric, with a ceiling (5%) and floor (2%).** Using 100% of CPI will likely result in a lower rent increase threshold, which may increase the likelihood that rental housing in Hayward becomes more affordable to tenants over time. The majority of Hayward renters are housing cost burdened, and one in four are severely cost burdened, even accounting for gains in income. Using CPI as a threshold would likely mitigate affordability concerns over time by allowing tenants to realize economic gains. Landlords may still receive a fair return through this threshold. If a landlord's net operating income, which factors in their operating costs, is less than the percent change in CPI, the landlord can request a higher rent increase to cover costs and receive an annual increase in operating profit.

The following table summarizes the strengths and challenges of those two threshold options:

Table 1. Comparison of Threshold Options

Threshold	Strengths	Challenges
<i>Fixed</i>		
Fixed percentage (Current RRSO)	<ul style="list-style-type: none"> • Predictability • Long-term market-rate return • Aligns with Hayward's fair return standard • Simple to understand and interpret • Minimizes confusion about rapidly changing policies • Allows staff to prioritize other housing policies and programs 	<ul style="list-style-type: none"> • May out-pace income growth of tenants over time • May not be an effective tool to reduce housing cost burden
<i>Economic Index</i>		

⁵ September 3, 2020, HHTF Staff Report and Materials:
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Threshold	Strengths	Challenges
Fixed		
Consumer Price Index (Bureau of Labor Statistics)	<ul style="list-style-type: none"> • May mitigate cost burden over time • Aligns with Hayward's fair return standard • Captures increase in cost of many apartment operating expenses • With existing RRSO provisions, landlords can request higher rent increase if operating costs increase at a higher rate than rents 	<ul style="list-style-type: none"> • Can be difficult to interpret • If only a fraction of CPI is used, it will likely not result in landlords making a fair return • If the rate of operating costs exceeds the rate of increase in CPI, the landlord will have to petition for a fair return

The HHTF voted 2 to 1 to move forward with the second option listed above: lowering the threshold to CPI. Should Council not vote to implement the change recommended by the HHTF, the existing threshold would be maintained.

Implementation of the New Stabilization Threshold

There are important logistical considerations to be made if the Council chooses to adopt and implement the CPI threshold. Since the threshold changes annually, the timeline for determining the threshold must allow enough time for staff to analyze the CPI data and announce the threshold. There must also be time for landlords to notice their tenants of the new threshold. Additionally, as the fair return standard is calculated on a calendar year, it is important to align the threshold calculation to the same schedule, if possible. With that in mind, staff recommends that 1) the new threshold would go into effect on January 1 of every year and 2) the threshold would be determined using August CPI data (i.e., the percentage change from August to August each year).

Table 2 on the following page illustrates the calculation of the rent increase threshold that will be effective January 1, 2021 if the proposed amendment is approved by City Council.

Table 2. Threshold Calculation

Determining the Percentage Change in CPI	
CPI All Items SF-Oak-Hay: August 2019	295.49
CPI All Items SF-Oak-Hay: August 2020	300.182
Difference in CPI	4.692
Percent Change (Rounded to Nearest Tenth of a Percent)	1.6%
Determining the Threshold Level	
Annual Percentage Change in CPI	1.6%
Rent Increase Threshold Floor	2%
Rent Increase Threshold Ceiling	5%
The annual percentage change in CPI (1.6%) is less than the threshold floor (2%). Therefore, the threshold for Calendar Year 2021 is 2%.	

Based on the proposed legislation, the rent increase threshold effective in 2021 would be 2% because the annual percent increase in CPI is less than 2%. Staff would calculate and publish the rent increase every September so landlords would be able to provide timely rent increase notices to tenants with January 1 rent increase anniversary dates.

Finally, it is important to also consider the opportunity costs associated with proceeding with this item and changing the RRSO threshold. The time and cost investment required for outreach and education of tenants and landlords anytime a substantial change is made to the RRSO can be significant. Specifically, this change has already delayed identification of affordable housing funding priorities until March 2021 and will likely reduce staff capacity to monitor and respond to COVID-19 related housing impacts.

Conclusion

Staff recommends that Council considers a recommendation from the Homelessness-Housing Task Force (HHTF) to adopt an Ordinance amending Chapter 12, Article 1 of the Hayward Municipal Code lowering the rent increase threshold from 5% to the annual percent change of Consumer Price Index (CPI), but no lower than 2% and not to exceed 5%. If adopted, based on the proposed legislation, the rent increase threshold for 2021 will be 2% and staff will adjust the rent increase threshold annually in January based on the percent change in CPI using August data.

If Council does not adopt the proposed legislation, the existing fixed percentage threshold at 5% would remain in effect.

ECONOMIC IMPACT

A change in the RRSO residential rent increase threshold would have an economic impact on landlords of covered rental units. Changing from a fixed percentage threshold would a) lower the current rent increase threshold and b) make the increase threshold less predictable. Landlords can petition the Rent Review Office for a rent increase that is greater than the

threshold if they are unable to make a fair return on their rental property at the existing threshold.

FISCAL IMPACT

There are some additional costs associated with this work, including additional outreach communications (e.g., landlord-wide mailing and staff time to communicate new information to landlords and tenants) and educational workshops. These additional costs can be absorbed under the existing budget allocation for the Rental Housing Program Fund.

STRATEGIC ROADMAP

This agenda item supports the Strategic Priority of Present, Protect, & Produce Housing. This item is not specifically related to a project identified in the Strategic Roadmap. Staff is bringing forth this new item at Council's direction. Performing the analysis presented in this report has created delays in staff's ability to complete other projects identified on the Strategic Roadmap. If the Council adopts the new methodology, there will need to be significant staff time spent on implementation this winter as well as landlord and tenant outreach about the change. In addition, there will be additional work annually to notify landlords and respond to inquiries as the rent increase threshold is likely to change every year.

PUBLIC CONTACT

Council received public comment on the July 14, 2020 RRSO and Tenant Relocation Assistance Ordinance item, which staff took into consideration in the development of this report. Additionally, staff provided notice of the HHTF meeting to the Housing Division's interested parties list, as well as representatives from landlord and tenant groups, and received written and live comment at the HHTF meeting. Comments from landlord and real estate groups emphasized concerns that a lower threshold would prompt many property owners to sell their properties or remove them from the rental market. Comments from tenant groups emphasized concerns about housing affordability and supported changing the rent increase threshold to the annual percentage change in CPI.

NEXT STEPS

Should the Council choose to approve the proposed legislation, the next step would be a second reading at the next regularly scheduled Council meeting. If approved at the second reading, staff would spend the remainder of the quarter developing outreach material and resources to support landlord compliance with the revised Ordinance. Staff recommends that the Ordinance revision be effective January 1, 2021, to align with the fair return calculation and to give landlords sufficient time to notice tenants.

Staff proposes the following timeline for next steps:

- November 2020: Item adopted at next City Council Meeting
- November – December 2020: Staff create resources and conduct outreach to landlords and tenants to notify them of the change and post the new threshold online
- January 1, 2021: Revised RRSO effective date and effective date of the new threshold

Prepared by: Amy Cole-Bloom, Management Analyst II

Recommended by: Christina Morales, Housing Division Manager
Jennifer Ott, Deputy City Manager

Approved by:

A handwritten signature in black ink, appearing to read 'K. McAdoo', is written over a horizontal line.

Kelly McAdoo, City Manager