

Attachment C
Homeowners' Arbitration Pre-Hearing Brief

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10 **BEFORE THE COUNTY OF SANTA BARBARA**
11
12 **MOBILE HOME RENT CONTROL ORDINANCE**

13 In re:) **HOME OWNERS' ARBITRATION PRE-**
14 NOMAD VILLAGE MOBILEHOME PARK,) **HEARING BRIEF**
15)
16)
17) Arbitration Hearing Date: June 9, 2011
18)
19) Hearing Officer: Hon. Luis Esparza
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Petitioners, NOMAD VILLAGE MOBILE HOMEOWNERS (hereinafter "Home Owners"), hereby submit the following pre-hearing brief and legal points and authorities in support of their Petition filed herein.

I.

STATEMENT OF FACTS

Nomad Village is a 150-space mobilehome park located in an unincorporated area within the County of Santa Barbara (hereinafter "the County), and subject to the County of Santa Barbara Mobile Home Rent Control Ordinance (hereinafter "the Ordinance") found at Chapter 11A of the Santa Barbara County Code of Ordinances. All spaces within the park are covered by the Ordinance; none are subject to long-term leases which are exempt from rent control. Space rents in the park range from a low of \$287.00 to a high of \$430.00. The average space rent in the park is approximately \$315.00, pending the outcome of this Petition. The noticed increase of

1 \$161.00 plus 75% of CPI for the last three years will thus result in more than a 50% increase in
2 rental cost for the average Homeowner, and for some shall be much larger.

3
4 The park land is owned by a family trust, but is leased to the park operator. For many
5 years, possibly as many as 50, a ground lease apparently governed this relationship. When that
6 lease expired in 2008, it was not renewed with the former park operator. The current operator,
7 Lazy Landing, LLC (hereinafter the "Park Owner"), signed a new 34 year lease effective August
8 1, 2008, which includes a monthly ground lease amount negotiated at the time of purchase that
9 calculates rent as a twenty (20%) percent of the gross rental income received by the Park Owner.
10 Due to the expiration of the prior long-term lease, the County apparently reassessed the local
11 property tax due to a "change of ownership". It is undisputed that no annual rent adjustment, or
12 rent increase of any kind, has been charged to residents since the current Park Owner assumed
13 operations.
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15
16 On January 26, 2011, Homeowners received a 90-day Notice of rent increase as required
17 by law. Although it, and its attachments, are not a model of clarity, and tend to mix and match
18 terms in such a way that it is confusing and difficult to decipher, it is apparent that three distinct
19 rent amounts are being sought:

20
21 1. A CPI-based increase to existing base rent calculated based upon 75% of the CPI, which
22 Constitutes the annual adjustment which is allowed by the Ordinance without a hearing. A
23 cumulative total of three years' worth of annual adjustment is included in the notice, since rent
24 has not been increased for three years. This amount differs for each homeowner, but
25 approximates \$7-10.00 per month. Homeowners are not objecting to this specific portion of the
26 increase.
27

28 2. An additional "permanent increase" to base rent in the amount of \$58.16, which is

1 derived from alleged increases in property taxes and ground lease payments. Homeowners do
2 object to this amount.

3 3. An additional "temporary increase" which is styled as a 7-year pass through in the
4 amount of \$102.84, which appears to be based upon four pass through categories involving
5 alleged capital expenses that are to be amortized over time, and not considered as ongoing
6 operating expense. Homeowners also object to this amount.

7
8 Meet and confer sessions and an exchange of incomplete information ensued with
9 authorized resident representatives, however no settlement or accord could be reached. Thus,
10 Homeowners timely filed a Petition pursuant to Ordinance sec. 11A-5 (b), contesting the rent
11 increase and requesting a hearing. The Petition was filed because the sum total of \$161.00
12 which exceeds the three years' of cumulative CPI increases, far exceeds 75% of the CPI, and is
13 thus reviewable under the Ordinance. The Ordinance does not require, nor do the County's
14 "Mobilehome Rent Control Rules for Hearings" mandate, that any particular basis for the
15 Petition be identified on its face. The County has verified that the Petition was indeed filed by a
16 homeowner majority, and that it is valid.

19 II

20 **THE PARK OWNER'S OBJECTIONS TO THE PETITION SHOULD BE OVERRULED**

21
22 The Park Owner filed a response to the Homeowners' Petition which sets forth two
23 objections to the Petition. Each should be denied.

24 The first is rather confusing, but appears to allege that since the \$161.00 sought in
25 addition to the cumulative annual "75% of CPI adjustment" is not "rent", but has been labeled by
26 the Park Owner as something else, it is not reviewable. In fact, a portion of the \$161.00 is
27 requested to be permanent, and thus cannot be anything but base rent in character. It will be
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1 charged monthly for the use of the mobilehome space, and clearly is part of the "noticed
2 increase" as that phrase is used in Ordinance sec. 11A-5 (a), (b) and (d). Review by a hearing
3 officer is not limited only to amounts which the Park Owner might choose to label as "base rent",
4 but applies also to a review of capital expenses or increased operating expenses which the park
5 owner might attempt to capitalize and pass through to the residents as a "temporary increase".
6 Support for this appears in Ordinance sec. 11A-5 (a) (3), which requires that such amounts be
7 itemized in the notice of increase (which the Park Owner attempted to do), and again in sec.s (4)-
8 (6) thereof, which allow the hearing officer to award amounts to cover increased costs of capital
9 expenses, new or old, or capital improvements. Clearly the items which comprise the \$161.00
10 are subject to review once a hearing is requested, as here. Otherwise, a Park Owner could "end
11 run" the Ordinance by calling these increase amounts something else, and realize large increases
12 in monthly rental charges without any review. It is the entire "increase" which must be
13 measured, and here the \$161.00 amount is required to be reviewed. Thus, this objection should
14 be overruled.

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18 Additionally, Park Owner appears to challenge whether the Petition was properly signed
19 by a Homeowner majority. The process of verification is delegated to the County Clerk, who in
20 this case has not rejected the Petition. Pursuant to Rule 4, the Petition is thus deemed verified.
21 Absent evidence to the contrary, the Clerk's finding should control, and the objection be
22 overruled. Should the hearing officer wish to subpoena the Clerk or review the actual Petition to
23 verify signatures, Homeowners have no objection. But the word of the Clerk should control, and
24 Homeowners should not be made to produce at hearing every resident who signed the Petition in
25 order to verify same. It is really unknown what the Park Owner is requesting to be done in this
26 regard.
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III

**THE PARK OWNER'S REQUEST FOR \$58.14 IN "PERMANENT RENT INCREASES"
SHOULD BE DENIED IN ITS ENTIRETY**

Homeowners are unsure, based upon the submission of documents so far, as to the exact basis for many elements of the total rent increase sought, and shall reserve their right to expand upon their list of objections both during the hearing, at closing argument and in post-hearing briefing once the evidentiary portion of the hearing is concluded. But based upon what has been submitted so far, Homeowners shall be objecting to the increase amounts labeled as "Permanent Increases" in the Park Owner's increase summary sheet (Items labeled as 1 and 2) based upon the following:

1. General Objections and Observations

Contrary to the Park Owner's assertion that the Ordinance "provides for rent increases for increased Park operating expenses" in the "dollar-for-dollar" fashion which appears on the rent increase summary sheet filed along with its Notice, the Ordinance does not. While the Hearing Officer is given ability in Ordinance sec. 11A-5 (i) to order an amount in excess of one-half of the automatic increase (i.e. 75% of CPI) to "cover operating expenses", that section goes on to state that the Hearing Officer has discretion "to add such amounts as are justified by the evidence..." Subsection (f) thereof describes a laundry list of factors to be considered (i.e. which "may" be included), and again refers to "all relevant factors". Merely identifying an increase in one expenses category cannot be used to pass through that entire increase without looking at all relevant factors. While an increase in an expense item is relevant, and should be considered, it must be considered in a proper context; i.e. within a fair return formula which

1 takes into account all expenses and income of the park owner. A direct pass through of a
2 specific expense item is not authorized by the Ordinance; the pass through of a capital item is.

3
4 There is also no precedent in Fair Return theory or analysis for the kind of passing
5 through of an expense change “in total” such as the Park Owner seeks here. The Park Owner’s
6 expert, Michael St. John, is in agreement with this premise, since he has employed a calculation
7 which, although not specifically referenced in the Ordinance, is a well recognized fair return
8 theory adopted by many ordinances and approved by the Courts. The Maintenance of Net
9 Operating Income (MNOI) analysis has been praised by commentators for both its fairness and
10 ease of administration, and was approved by a Court of Appeal in connection with a rent increase
11 hearing in the City of Oceanside. *See Oceanside Mobilehome Park Owner’s Assn. v. City of*
12 *Oceanside (1984) 157 Cal. App. 3d 887.* In 1998, in a case involving application of Escondido’s
13 mobilehome ordinance (which, as with the case of this Ordinance, listed factors to be considered
14 in a fair return case but did not identify a specific formula or methodology for calculating fair
15 return), the court specifically upheld the use of an MNOI approach, calling it a “fairly
16 constructed formula” which provides a “just and reasonable” return on investment. *See Rainbow*
17 *Disposal v. Mobilehome Park Rental Review Board (1998) 64 Cal. App. 4th 1159.*

18
19 Ordinance sec. 11A-1 states that as an overriding purpose, the Ordinance is designed to
20 ensure that a park owner receives “a fair return on their investment”. An inquiry into fair return
21 is thus appropriate. Any fair return analysis should be fairly used, and MNOI fits the bill. The
22 fact that the park owner’s own expert has chosen this theory to presumably verify the Park
23 Owner’s requested increase amounts establishes that it can and should be used by this Hearing
24 Officer as an objective and court-tested standard by which the “reasonableness” of the requested
25 rent increase can be determined. But as stated below, this MNOI theory that the park owner has
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1 chosen, and which the Homeowners will accept as the standard to use, must be properly applied,
2 and there are numerous questions and errors in the St. John work which must be corrected and
3 sorted out.

4 **2. Specific Objections and Challenges**

5 **A. Property Tax Increase**

6
7 Notwithstanding the foregoing, and the need to recognize this as but one expense which
8 should be inputted into a proper MNOI formula (see below), the stand alone calculation which
9 Park Owner has attempted here does not support a rent increase in the amount requested in any
10 case, for the following reasons (more may become apparent at the hearing):

11
12 -This amount, which the "Notes" attached to the Rent Increase summary sheet state shall not be
13 "passed through" if a challenge to the assessment is successful (thus tacitly admitting that this
14 increase is being attempted as a 'pass through'), may not even legally be owed, and thus should
15 not be allowed until any legal challenge is completed (although it appears that the park owner
16 has not yet even initiated any such challenge, and indeed may be waiting for the Hearing Officer
17 to award its projected attorney's fees first before it would do so!). The real questions are: What
18 is the basis for any such challenge? Why does the park owner feel so strongly about it? And
19 what chance does the Park Owner have to succeed?
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23 -The amounts have not been correctly calculated even if one were to accept the manner in which
24 they are presented. The detailed income and expense sheet produced by Park Owner shows
25 actual property tax expenses of \$21,199.58 in 2008 and \$59,255.26 in 2009, which would yield a
26 different result when using the differential to calculate a rent increase. Assuming such a "stand
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1 alone" theory was used, the actual difference would be \$38,055.68, and not the \$46,070.00
2 amount claimed.

3 -A further miscalculation results from the fact that supplemental and unsecured taxes were billed
4 for 2008 in the sum of \$42,507.67, and should thus be added to that year's amount, which would
5 yield a total of \$62,960.67. This results in an increase in 2009 of only \$3,562.33.
6

7 B. Lease Payment Increase

8 Notwithstanding the foregoing, and, as stated above, the need to recognize this
9 item also as but one expense which should be inputted into a proper MNOI formula (see below),
10 the stand alone calculation which Park Owner has attempted here does not support a rent
11 increase in the amount requested in any case, for the following reasons (more may become
12 apparent at the hearing):
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14 -The ground lease payment is not an operating expense, but rather an investment expense
15 incurred by the Park Owner in connection with the acquisition of the park. It is a payment from
16 one owner to another, made in connection with the purchased right to control the land. As such,
17 it is a bargained for part of the purchase price, and not an expense. MNOI calculations would
18 typically not allow such an item, since it is circular in nature (i.e. an increase in revenue
19 increases the ground lease payment, which in turn requires an even greater increase in revenue,
20 and so forth), and thus iterative.
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24 -There has been no production of the former lease agreement, pursuant to which it is claimed that
25 former ground rents were calculated based upon 10% of gross income, as opposed to 20%.
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1 -Even if the manner of presentation in item 2 of the increase summary is accepted, the
2 calculation is incorrect. According to the income and expense detail, the actual paid lease
3 amount in 2008 was \$83,288.42, and not \$54,905.00. Thus, the actual differential between 2008
4 and 2009 is \$30,238.00. (Together with the corrective calculation above, this yields a total
5 difference between 2008 and 2009 for Permanent Increases of \$68,293.68, which would result in
6 a rent increase of \$37.94 even if this 'stand alone' theory was proper).

8 **3. Errors and Omissions in the St. John MNOI Analysis**

9 As previously stated, Homeowners do not object to the use of the MNOI formula, and are
10 willing to accept it as the best fair return formula to be used in this case. But it must be properly
11 and accurately applied. The Park Owner's expert has presented an MNOI analysis which
12 appears to be a supporting calculation for the \$58.16 "permanent increase". Mr. St. John's
13 calculation concludes that a \$60.62 rent increase is warranted at 100% indexing of the CPI, with
14 a \$50.52 increase authorized at 75% indexing (the latter is common in local mobilehome rent
15 ordinances throughout California). Presumably, this calculation was presented to show that the
16 requested amount of \$58.16 is thus "reasonable", and supported by an accepted fair return
17 analysis.

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19
20 But there are a number of errors and omissions in the St. John work which must be
21 addressed. Some are errors in calculation. For example, a significant error is made in
22 calculating property tax expense for 2009 (see page 2 of MNOI analysis), which the
23 accompanying calculation notes indicate to be stated "net of sewer service". But the
24 \$112,111.12 figure shown still includes the \$54,587.91 in sewer fees billed to the Park Owner
25 for 2009. The correct figure should be \$66,523.00, as noted in item 1. On the rent increase
26 summary sheet. Elsewhere, the 2009 MNOI calculation shows an amount of \$52,366.27 for
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1 sewer expense; a number which cannot be accurately traced. Reducing the 2009 expense total by
2 this \$54,587.91 amount in turn reduces the authorized MNOI increase to \$30.29 at 100%
3 indexing, and to \$20.20 at 75% indexing.
4

5 The inclusion of lease payments is, as noted above, also improper, and if the \$74,188.50
6 expense differential amount from this item is excluded from the calculation, MNOI will yield a
7 permissible increase of less than zero.

8 There are other questions relative to the MNOI application which must be asked:

9 -Why was 1994 chosen for the base year?
10

11 -Why are some base year categories left blank which do not appear to be included elsewhere,
12 such as "protective services", "rent-employee housing", most 'repair and maintenance' items,
13 "garbage expense", "taxes-property", "licenses & permits", and "payroll service"?

14 -How was the "current year" of 2009 chosen?
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16 -What was used to calculate rental income? Are rent rolls available for Homeowners'
17 inspection?

18 -Where does the 2009 sewer expense of \$52,366.27 come from?
19

20 The MNOI analysis cannot be properly applied until these questions, and likely other
21 questions which shall become apparent during the hearing, are answered.

22 IV

23 **THE PARK OWNER'S ATTEMPT TO PASS THROUGH \$102.84 IN "TEMPORARY** 24 **INCREASES" SHOULD BE DENIED IN ITS ENTIRETY**

25 To repeat, Homeowners are unsure, based upon the submission of documents so far, as to
26 the exact basis for many elements of the total rent increase sought, and shall reserve their right to
27 expand upon their list of objections both during the hearing, at closing argument and in post-
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1 hearing briefing once the evidentiary portion of the hearing is concluded. But based upon what
2 has been submitted so far, Homeowners shall be objecting to the increase amounts labeled as
3 “Temporary Increases” in the Park Owner’s increase summary sheet (Items labeled as 3 through
4 6) based upon the following:

5
6 **1. General Objections and Observations**

7 Each of the items described in this section is sought as a “pass through”; i.e. the amount
8 requested is designed to be amortized over a number of years, with interest, to reimburse the
9 Park Owner for the cost of the item. This constitutes treatment as a capital item, rather than a
10 deductible expense. But to be treated as a capital item, here for which payment is sought before
11 the expenses have actually been incurred, the following must be true:

12
13 -The improvement or repair for which the increase is sought must be specifically identified, so as
14 to confirm that it is indeed a capital item, as opposed to a deductible expense. Park Owner has
15 failed to specifically identify any of the proposed capital improvements for which the
16 \$320,000.00 identified in item 3, together with \$140,000.00 of engineering and “professional
17 fees”, is sought (it appears beyond dispute that recovery is being prospectively sought for these
18 items; i.e. before any work is contracted for or commenced), other than a cryptic list of
19 “Clubhouse Repairs and Replacements”, “Street Repairs” and “Electrical Upgrades” which was
20 provided at some point during the meet and confer process (the latter of which is not an
21 authorized pass through pursuant to both Public Utilities Commission decisions and California
22 case law). The request for capital improvement monies is premature and unsupported.

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27 -The projected cost of the items must also be disclosed, not only because it is important to
28 classifying the capital status, but also because there needs to be some reasonable correlation

1 between the amount sought and the projected work to be done. Bids, invoices, and proposals are
2 needed here, rather than vague lump sum estimates which could potentially be allocated
3 anywhere. The absence of any sort of cost estimate again makes this request premature and
4 unsupported.
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7 -Ordinance definitions of a "capital improvement" and a "capital expense" must be met in order
8 to authorize the increase; i.e. the "addition or betterment" must be identified, or the "existing
9 facilities or improvements" for which the expected repair or replacement adds an expected life of
10 at least one year. Until the specific work is identified by type and cost, these definitions, found
11 in Ordinance sec. 11A-2, cannot be established.
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14 -"Anticipated Professional Fees", including legal fees, which are claimed as capital items in
15 items 3, 5 and 6 need to be specifically explained and accounted for, as well as supported by
16 good faith estimates. Such items are not considered as capital expenditures, and thus cannot be
17 amortized and passed through, where their inclusion would violate Internal Revenue Service
18 precedent. In Revenue Ruling 78-389 (1978-2 Cum. Bull. 125), the Service found that legal
19 expenses incurred in the prosecution of a suit to invalidate as municipal ordinance that would
20 prohibit the operation of a taxpayer's business were deductible as ordinary and necessary
21 business expenses when they arose from the taxpayer's business activities and did not result in
22 the acquisition or disposition of a capital asset.
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1 **2. Specific Objections and Challenges**

2 A. Capital Improvements

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4 Again, it is unknown whether any of the engineering or architectural services have been
5 incurred or even estimated, while not specific work of any kind has been identified so as to
6 determine whether the item in question qualifies as a capital item. Homeowners know of no
7 proposed improvement which has been required by a change in any governmental law or
8 regulation. Thus, the attempted pass through is not “automatic”, but must be proven by evidence
9 and deemed reasonable by the hearing officer. Ordinance sec. 11A-6 (1) (C) specifically
10 conditions such a pass through upon “approval at hearing”. The same analysis applies to a
11 capital expense; i.e. there is no automatic pass through where the repair is not required by a
12 governmental regulation. Here the Rent Increase summary sheet calls the entire amount “capital
13 improvements”, which means that the definition found in Ordinance sec. 11A-2 (a) must be
14 established. It is unclear how or why \$50,000.00 of “professional fees” would be required in
15 connection with any proposed capital improvement, especially since architectural and
16 engineering costs have already been broken out separately. And while reasonable financing
17 costs are allowed under the ordinance, no calculation has been provided which demonstrates how
18 financing costs were factored into the Park Owner’s dollar requests here.
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22 B. Uncompensated Increases

23 This category attempts to pass through retroactively, supplemental tax and land lease
24 allegedly incurred in 2008 and 2009, and for which the park owner chose not to previously seek
25 any increase during those years. There is no precedent in the Ordinance for such a theory, which
26 if allowed would enable a park owner to go back in time any number of years to allege that an
27 expense increase, or one-time payment of some type, had not been fully compensated. These are
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1 not capital items, and are subject to the same analysis set forth in Headnote III above. These
2 amounts are compensated as a part of the three years of automatic CPI increases which will be
3 allowed by the Hearing Officer. They were never noticed when incurred, and recovery was
4 never sought when the expense was incurred. To allow them now would create a precedent for
5 retroactive recovery which would make such expenses difficult to track or prove, and which
6 would keep Homeowners at risk of having to pay rent increases to cover new expense item
7 whenever discovered, or whenever the park owner might get around to requesting them. This
8 would also create chaos and play havoc with prior increases ordered based upon facts and data
9 then presented, which could be turned on its head by new "expenses" claimed in later years for
10 the same periods.

13 Again, taxes associated with the purchase are not recognized as operating expenses in fair
14 return analysis; nor are land lease payments.

16 Finally, the calculation presented for this item 4 in the Rent Increase summary incorrectly
17 counts for 34 months, when instead the number of months from August, 2008, when Park Owner
18 acquired the lease rights, through April, 2011 (i.e. the last month before the requested increase
19 would take effect) is 33 months.

21 C. Anticipated Professional Fees – Property Taxes

22 This is clearly not a capital item, since it does not relate to the acquisition or disposition
23 of a capital asset, and because it is prospective as per its definition it has not yet become an
24 expense of the Park Owner. If actually incurred, the Park Owner is free to include this amount in
25 a future rent notice, where it can be properly analyzed and adjudicated under the Ordinance.
26 Furthermore, no basis for the expense has been disclosed; i.e. it is unknown who the fees would
27 be paid to, what they would seek to accomplish and what good faith basis, if any, exists for
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1 achieving any benefit to the Homeowners. The fact that the Park Owner has not, to date,
2 initiated any such challenge speaks volumes about the confidence level in such a pursuit, and
3 how Homeowners would in any way be “bettered” by such a cost. Homeowners cannot be
4 expected to fund what could turn out to be fruitless legal challenges, and provide the Park Owner
5 with the equivalent of an attorney’s fee guarantee, even if the Park Owner were to lose.
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7 D. Anticipated Professional Fees – Rent Increase

8 This category represents a complete unknown at this point. But it can be inferred, due to
9 the huge amount projected that it encompasses not only the legal fees require for this 1-2 day
10 hearing, but also fees to fund a projected appeal through the courts if the Park Owner were to
11 lose all or any portion of its case at the administrative level. For that reason, all of the arguments
12 set forth in (C) above would apply to this item.
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14 In addition, there is no authority to prospectively pass through attorney’s fees incurred to
15 obtain a rent increase on a dollar for dollar basis. Once they are actually incurred, such fees
16 could be included as an expense item in a fair return calculation for a future year. *See Galland v.*
17 *City of Clovis (2001) 24 Cal. 4th 1003.* But merely projecting a lump sum of fees which are
18 anticipated, and then seeking to pass that amount through with financing costs apparently
19 included, is not authorized by the Ordinance, or by any known authority. Again, it is unknown
20 to whom these fees would be paid, for what and in what amounts. The Ordinance does not allow
21 for the writing of such a “blank check”.
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SUMMARY OF HOME OWNERS' POSITION

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Only the CPI portion of the increase is deemed "automatic" based upon evidence or authority presented thus far by the park owner. All other portions of the requested increase; i.e. the \$161.00 amount, must be reviewed by the Hearing Officer before they can become an ongoing part of the monthly rental cost, whether as base rent or a pass through. Homeowners objections to the amounts sought are based not only upon methodology, but also upon errors and inconsistencies in the calculations themselves. Homeowners cannot at this point even begin to calculate all of the different amounts which might be awarded if only certain mistakes are corrected or certain re-calculations are made. But they need not do so in any case, for the bottom line is this: If the mutually accepted MNOI formula is properly applied, with the land lease payment extracted and the property tax amount corrected by subtracting the 2009 sewer charge, the amount to be granted for the "permanent" base year rent increase above and beyond what is automatically allowed is "zero". And if the "temporary increases" are confined to legitimate capital items which have been properly identified and estimated by reasonable cost, then the allowable amount of any such pass throughs is also "zero" based upon the evidence so far presented.

For these reasons, and reserving the right to make additional arguments at hearing, Homeowners respectfully request that the Petition be granted and the \$161.00 requested increase be denied.

Dated: June 6, 2011

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Attorney for Home Owners