ARBITRATION

--o0o--

NOMAD VILLAGE MOBILE HOME PARK

RENT CONTROL HEARING

--o0o--

Monday, September 19, 2011

105 East Anapamu Street

Santa Barbara, California

OUR FILE NO: 68763

REPORTED BY: MARK McCLURE, CSR #12203

ORIGINAL

ARBITRATOR:

HONORABLE STEPHEN BIERSMITH
5462 Rincon Beach Park
Ventura, California 93110
(805) 648-7242
sbiersmith@aol.com

APPEARANCES OF COUNSEL:

FOR PETITIONER MOBILE HOMEOWNERS AT NOMAD VILLAGE:

LAW OFFICES OF BRUCE E. STANTON
BY: BRUCE E. STANTON, ATTORNEY AT LAW
6940 Santa Teresa Boulevard, Suite 3
San Jose, California 95119
(408) 224-4000

FOR DEFENDANT:

LAW OFFICES OF JAMES P. BALLANTINE
BY: JAMES P. BALLANTINE, ATTORNEY AT LAW
329 East Anapamu Street
Santa Barbara, California 93101
(805) 962-2201

ALSO PRESENT:

MARGO WAGNER

MARY McMASTER

KAREN FREEGARD

I N D E X

WITNESS	EXAMINATION	PAGE
MICHAEL ST. JOHN		
	BY MR. BALLANTINE	45
KENNETH K. BAAR		
	BY MR. STANTON	138
	BY MR. BALLANTINE	190
	BY MR. SANTON	243
	BY MR. BALLANTINE	250

E X H I B I T S

NUMBER	DESCRIPTION	PAGE
Joint 1	Text of Santa Barbara County Rent Control Ordinance	43
Joint 2	Notice of hearing	43
A	Notice of increase, 1/26/11	138
B	Example of space rent increase	138
C	Nomad Village space rent increase spreadsheet, 5/11	138
D	Tables	138
E	Curriculum vitae for Michael St. John, Ph.D.	138
F	CPI documents	138

E X H I B I T S (CONTINUED)

NUMBER	DESCRIPTION	PAGE
G	Property tax documents	138
H	Lazy Landing ground lease	138
I	Nomad Village, Inc., ground lease	138
J	Capital expense spreadsheet	138
K	Capital expense documents incurred by Waterhouse Management Corporation	138
L	Capital expense documents incurred by Nomad Village, Inc.	138
M	Proposals to Waterhouse Management Corporation	138
N	Nomad Village, Inc., financials, 1994, 2006-2008	138
1	Curriculum vitae of Kenneth Baar	144
2	Indexing Ratios in MNOI Standards	151
3	Detail from Gardena ordinance	162
4	Decision in Rainbow Disposal Company, Inc., versus Escondido Mobile Home Home Rent Control Board	168
5	Legal expenses	176
6	"Chapter 540-2, Mobile Home Space Rent and Stabilization"	182
7	Amortization table from unidentified document	183
8	Consent forms from homeowners	254

SANTA BARBARA, CALIFORNIA

MONDAY, SEPTEMBER 19, 2011, 9:14 A.M.

--o0o--

THE COURT: Good morning, everyone. Happy Monday. My name is Stephen Biersmith. I've been selected by the parties to serve as the arbitrator in today's matter, the following matter entitled "Argument in Support Of and in Opposition To a Petition" Filed by the mobile homeowners residing at the Nomad Village Mobile Home Park, located at 4326 Calle Real, Santa Barbara, California, 93110, contesting a rent increase in said mobile home park.

With that I would ask the parties to state their appearances for the record, beginning with Mr. Ballantine.

MS. STPHAO: Good morning, your Honor. James Ballantine appearing on behalf of the park operator, Nomad Village. The name of the park operator is Lazy Landing, LLC, and Waterhouse Management Corporation, with representatives from that, Mr. Waterhouse, one of the principals, and Mr. Ruben Garcia, vice president of Waterhouse Management, and Michael St John, a consultant.

THE ARBITRATOR: Okay, welcome.

Mr. Stanton?

MR. STANTON: Good morning, your Honor. Can I first ask, are we using these microphones at all?

THE ARBITRATOR: We'll have someone look into it.

With that, I would ask that the County to state their appearances for the record as well, please.

MS. McMASTER: I'm Mary McMaster. I'm a deputy county counsel for the County of Santa Barbara.

MS. FREEGARD: My name is Karen Freegard. I am a prior clerk for the ordinance.

MS. MARGO: Margo Wagner, serving as the clerk for the ordinance.

THE COURT: Thank you.

MR. STANTON: And I'm Bruce Stanton, here representing the petitioners, who are the homeowners and residents of Nomad Village Mobile Home Park, which is the subject of today's hearing.

There are a number of residents here, there are also some, I believe, persons from other nearby local mobile home parks here as spectators. I'm here along with Dr. Kenneth Baar, who is our expert. I have obtained written designation of representation forms from approximately 90 to 95 spaces, your Honor, which is my habit of doing in hearings like this, just so that we can be absolutely certain who I represent. I viewed the original of those this morning, they are being copied as we speak, and by midday today I'll have the document with a summary sheet on the front that indicates all the spaces that have signed the representation form.

THE ARBITRATOR: Off the record for a second.

(Discussion off the record.)

THE ARBITRATOR: So a couple things as far as protocols. This is a hearing, but not like a court of law. We're a little more fluid than that, but we exercise the same courtesies between the parties. So if you wish to speak to your attorneys, you probably will need to wait until a break to speak to your respective counsel. They have both been around for a while, they know what they're doing, so please, if you have a comment, if you hear something during the hearing, don't react, take a note, see your counsel during break and then he will take care of that matter as we resume.

With that, we're going to add some opening statements. It's a little different here as far as the petitioner and how this was framed. The attorneys had agreed that Mr. Ballantine will go first and, sir, you may proceed with your opening statement.

MR. BALLANTINE: Thank you, your Honor.

Good morning. This is a hearing under the

Santa Barbara County Rent Control Ordinance, and that ordinance was enacted in 1979 and amended in 1986. It's purpose is to protect tenants against unfair rent increases, but also to protect the park owners from facing increased costs and make sure they're able to have a fair rate of return in their mobile home parks.

This particular park that's in question, Nomad Village Mobile Home Park, is located at Calle Real near El Sueno Road. It has 150 spaces. It was developed initially in the late 1950s. Essentially it was a trailer park at the time, and over the years it became a larger park in the sense that mobile homes got bigger and moved in there.

The land is owned by the Bell Family Trust. The Bell Family have been the longtime owners. Mrs. Bell -- maiden name Botini -- it came down from her family, and they initially leased it to the first operator, Nomad Village, Inc., back in the 1950s, or at least the principals of Nomad Village, Inc., in the 1950s, and they operated under a long-term ground lease that expired on July 31, 2008, and that was Nomad Village, Inc., the prior operator.

A couple things happened that are relevant to the park proceeding today under the prior operator, and it concerns the infrastructure of the park. The County had some issues in terms of the infrastructure of the park that were discussed by the former operator, and the former operator obtained plans for upgrades to various infrastructure of the park.

There was also a failure to maintain lawsuit filed by about 40 of the residents against the operator, and that case was resolved and didn't involve the current operator.

As I said, the long-term lease that the prior operator had expired July 31, 2008. At that point in time the current operator took over operations starting August 1st, 2008. Lazy Landing, LLC, became the operator of the park under a 34-year ground lease, and its related management company, Waterhouse Management, Inc., took over day-to-day management of the park. They're experienced mobile home park operators, and Waterhouse Management manages a number of parks throughout the state.

They conducted due diligence. They went back and forth with the County on issues regarding the infrastructure of the park and made various assessments of what needed to be done with the park. Issues with the County have been resolved.

One of the things that happened was they got notification in about 2009 that there was going to be a significant property tax increase, and the reason for that was because the County took the position that the expiration of Nomad Village, Inc.'s, ground lease constituted a change of ownership, and that change of ownership triggered reassessment. As a result of that reassessment that occurred at that time, property taxes essentially doubled.

In any event, that and the infrastructure and the increased lease costs led to the rent increase that, I think, brings us here today.

I would note a couple things about the rent increase. First of all, in full, the rent increase at issue that is the subject of this proceeding, the current operator had never given a rent increase since they took over operations in August of 2008.

Secondly, at least since 1994, because, we have records from 1994, the prior operator never sought any kind of increase in the base rent other than the annual CPI escalation that they're entitled to, which is 75 percent of the CPI.

Let me talk a little bit about the notice of rent increase and the rent increase. You'll see the notice of rent increase is Exhibits A and B. This is the notice that went out to the homeowners.

Exhibit C is a document we'll be talking about and Dr. St. John, who prepared this, will be talking about this. But Exhibit C is essentially a spreadsheet that explains the basis for the particular numbers that led to this rent increase and the reasons for it. And I want to just briefly go over those and, of course, we'll be having testimony in some detail about these issues and about how they're supported under the Santa Barbara County Rent Control Ordinance that we're operating under.

It basically has two types of components, a permanent increase and a temporary increase. The permanent increase has two components and I'll be talking about that first and then I will talk about the temporary increase.

The permanent increase would be an adjustment in the base rent going forward based upon the increased operating costs and, as I indicated, we are not aware of any such permanent space rent increase since the rent control ordinance came into effect and certainly since 1994 at this particular park.

The first basis for the permanent increase is the property tax increase. This outlines, essentially, how the basis of the numbers were derived. The property tax bill has a bill for sewer fees that had to be backed out of the bill, and that comes up with a number that supports the increase.

The second is for the lease payment increase. Now, as I indicated to you before, during the entire time that Nomad Village has been a mobile home park it's always been operated by an outside operator, and one of the things the outside operator had to do was pay rent for the ground lease to operate the park. We presented the ground lease from Nomad Village, Inc., as one of the exhibits, and that shows that the basis for the rent was 10 percent of the gross rents collected.

Under the current lease, the property owner has demanded and received 20 percent of the gross rents collected as the rent, so essentially what that's meant is a de facto doubling of the lease payment, and there's a calculation set forth there that comes up with that number. So these are the two components of the permanent increase that has been noticed to the homeowners, and that's the basis by the calculation for that. Essentially, they're both specific increased operation costs that the current operator has regarding this mobile home park.

Secondly, there's a temporary increase, and that has subcomponents to that. Now, the distinction of the temporary increase is that it's something that's temporary -- in other words, it goes on for a period of time and then it phases out entirely.

The first area is capital improvements, and capital improvements or capital expenses, they are both defined under the Santa Barbara County Rent Control Ordinance, but essentially long-term improvements to the park, and that has three subcomponents.

Architecture and engineering fees, $90,000, and we'll present evidence on that. Those were incurred by -- entirely by the prior operator, they had extensive plans done and permits obtained for the park, they had engineering done that was prepared into a topographical map of the entire park and park infrastructure and they prepared detailed plans in accordance with that.

Second are professional fees that are about $50,000 that are legal fees relating to, essentially, dealing with the County and other things relating to legal work relating to infrastructure of the park.

The third area is the infrastructure, and it's $320,000. Now, let me talk about that. We'll have evidence of exactly what that is. That is a payment made by Lazy Landing into an escrow account. It was paid in in 2008, and it specifically designated for park infrastructure. None of the money has been spent yet, although it's been paid in.

We'll also present to you and you'll hear some evidence of the work that's planned under that infrastructure improvement. What's interesting about this in this particular case is the monies are paid in -- specifically paid in, and specifically designated for the park infrastructure. So money hasn't been spent on construction, but it has been drawn out of that account, and we'll present what the evidence of that is.

One of the things that's, perhaps, somewhat unique about the ordinance that we're operating under is that, unlike many jurisdictions, it doesn't have a component where if a park operator wants to increase the rents that they bring a petition to a board and asks for permission to do it.

The way that our ordinance is set up is simply that a rent increase is noticed, if the homeowners have an issue with it they can bring a petition, as they have done here, and then an arbitrator deals with it.

Another component or aspect of that is that since it's essentially retrospective in the sense that you do the -- you notice the increase and then if there's an issue with it, then you have a hearing, it also provides that one of the things that a rent increase notice can include is for proposed future work. And the reason for that is because there's no petition to bring in advance to ask to do the future work or to incur an expense in the future. So some of the infrastructure extension is a future expense and the ordinance specifically provides for that and it provides that the park operator can collect for future expense, and in the event that they do not incur that expense within six months of the rent increase being final, then they have got to pro rate -- they've got to do a rent reduction until they actually incur the expense.

So that's a little bit of nuance of this particular ordinance, and I believe in our hearing brief we cited for you and quoted the exact language from the ordinance.

But I wanted to bring that to your attention because we have a mixture here under capital improvements of expenses that have been incurred in the past and those that are anticipated in the future.

For the future expense you'll see some invoices -- or excuse me, bids that will show work that's being planned and what the costs are, and they far exceed the $320,000. There's things like some work on transformers, the electrical system, and there's things like a paving of the entire park. The paving alone costs over $400,000. It's far in excess of $320,000. You'll see about $50,000 in costs incurred towards the infrastructure by the operator to date.

The second component of the temporary increase is No. 4 on Exhibit C, uncompensated increases. Now what that is, is essentially to deal with the regulatory lag, or the lag in time between the time that the rent increase went into effect, which was May of this year, as noticed, and the time that the park incurred the increasing expenses and the land lease increase. And so that's simply to pick up those additional costs for the period in time at which they have been incurred.

No. 5 is anticipated professional fees related to the property taxes. Now, one of the things that the park operator is proposing to do is to challenge the property tax increase because it's been reviewed -- the initial thought by the park owner or the park operator and the ground owner was that the law seems to provide that the termination of the long-term ground lease has resolved or is considered under the Revenue and Taxation Code as a change of ownership, which is a term of art under the Revenue and Taxation Code. Change in ownership triggers the right to the assessor to have a property tax increase.

In looking at the issue a little further, there's some question as to whether or not, under the factual circumstances of this case, that truly applies and that's truly valid here, for a couple of reasons.

First, essentially what the assessor's position is, is bringing a retrospective interpretation of an existing contract. In other words, there's an existing lease that predated the Revenue and Taxation Code which said a long-term lease is a change of ownership, and the a general principle at law that you cannot interfere, you cannot tax existing contracts, essentially, you cannot change existing contracts. So there's real question as to whether or not the Revenue and Taxation Code could apply to this long-term lease.

Secondly, there's a question as to whether or not it truly is a long-term lease -- that is, over 35 years -- because of the fact that -- and you will see the lease in evidence -- because of the fact that it was amended in 1978, I believe, which would bring it within the 35 years, and there is there some argument that because of that amendment it doesn't make this a long-term lease.

And the final reason is that the assessor has consistently treated the property owner as being the Bell Trust and its predecessor and never the prior operator, Nomad Village, Inc., under the theory that the long-term lease, which expired on July 31, 2008, constituted a change of ownership. The County would have to recognize prior owner that was somebody other than the Bell Family Trust because their position is that the change of ownership was from Nomad Village, Inc., to the Bell Family Trust as of August 1st, 2008.

But if that's the case, then the assessor would have had to have recognized Nomad Village, Inc., and not the Bell Family Trust as the owner of the property and the taxpayer, and they did not do that.

And so that's a very thumbnail sketch, but that thumbnail sketch is why there could be a -- why the property tax increase may be subject to challenge.

Because of the fact that, as I indicated before, the way this ordinance works is that the park owners can propose a rent increase to the homeowners and give them an opportunity to challenge it. Rather than pursuing the property tax appeal, that option or that proposal was essentially advanced to the owners.

They contested that, they don't want the park owner to incur the expense to pursue the property taxes. It's still part of the rent increase, we think it's a good idea, and it will be discussed in this hearing, but again that goes back to the idea of a prospective expense, anticipated to be in the future, assuming that the rent increase is approved.

The final area of the temporary increase is anticipated professional fees relating to the rent increase, and that was the idea that if, where there is rent increase, there is expense related to rent increase, and if there's a challenge, that would involve a significant cost to the park, that would involve a significant cost to the park, and that's included here.

Let me note, one of the things about these last two items, the professional costs, is that there may be an argument that it should be considered as an operating cost. There may be an argument that it's not.

One of the things about not including it, not considering it to be a normal operating cost is actually beneficial to the homeowners, and the reason why is instead of those costs serving as a basis for a permanent long-term rent increase, they are instead the basis of a temporary rent increase. The thinking of the park owner on that would be that it's unfair to impose on the homeowners the basis for a permanent rent increase for, really, costs that are unusual and extraordinary, engaging in a piece or two pieces of potential litigation that, at least as to those pieces of litigation, one-time things, but they do involve a significant and unusual expense, it makes more sense to treat it as a capital expense than a temporary expense. In other words, you just look at the expense itself, you amortize it over a seven-year period, because that seemed to be an appropriate period, and so it's a temporary expense for a seven-year period, and that's the case for all of the temporary increases, the proposed period is seven years and at 9 percent interest rate, and I would note that the rent control ordinance is very specific in providing for the ability to do that. The idea that it's amortized over a reasonable period of time and that there's a reasonable interest rate attached to it, and the interest rate that we attached to it was 9 percent.

Coming down to the bottom of Exhibit C, then, this gives us the numbers we have. The permanent rent increase based upon the numbers above yield a rent increase of $58.16 and the temporary increase yields a rent increase of $102.84, for a total of $161, even.

Now, at the time that this was done this was supported by an analysis by Dr. St. John of what is called an MNOI analysis, maintenance net operating income, and the idea is to look at that to see whether or not the income of the park justifies the rent increase, the net income of the park justifies the rent increase. And I would note that that approach is an operating expense based approach; you don't consider a fair return on the actual investment, you don't say what does the park owner has invested in it and what's a fair rate of return. It evaluates a fair rate of return simply based on operating income. And at the time the park did that fairly cursory MNOI analysis, that that supported the $58.16. Basically what it told us was that the park was operating on a relatively marginal basis prior to having the lease payment bump up and double and the property tax effectively double, and by having those additional expenses by essentially directly including those in the increase, the MNOI analysis suggested that was supported.

Now, I would also note that the rent control ordinance has a specific procedure that the arbitrator in an arbitration proceeding is supposed to follow in order to determine whether or not there should be a rent increase, permanent rent increase based upon operating expenses. It's very similar to MNOI analysis but it's a little bit different, and Dr. St. John is very experienced in these matters and will talk about that and show you, through Exhibit D, essentially the calculations that he prepared.

He prepared what we call an NOI analysis, that's directly in accordance with the Santa Barbara County Rent Control Ordinance and the methodology that it prescribes, and you will hear more about the specific methodology employed and that will show -- what he did was, Dr. St. John used two base years. What you do is you do a base year and the current year, and you compare the two years.

And he looked at two base years, he looked at 1994 under the past operator, and he looked at 2007, the last year that the prior operator had it, and he compared those. In both cases they came out very close.

The primary difference would be that if you go back to 1994 and do an NOI analysis and if you just essentially factor it up at 75 percent of CPI, not a full CPI index, this reflects a lower rate.

If you factor it up to CPI, which we think is the appropriate number, then it supports the rent increase we're talking about. If you look at 2007, essentially, regardless of the methodology, use 75 percent or full CPI, both are supportive of this number, and the reason is for, essentially, the time period and the fact that you just go at 75 percent of CPI, that doesn't give you a full return to the park operator.

I would note that the rent control ordinance -- our ordinance here does not prescribe the base year that has to be used and Dr. St. John will explain to you why 2007 is the appropriate year to use to make that determination.

Now, I just want to give you an overview of the exhibits that we presented. It may be useful to have a lay of the land when you hear the specific testimony as to the documents that we have and how they're assembled and organized. I think I talked about Exhibits A, B and C, then Exhibit D are tables prepared by Dr. St. John. They were all in our arbitration brief and referenced in the arbitration brief, and those show the various components of the rent increase.

I would also note that the rent increase that was issued had a 75 percent of CPI component as part of the permanent space rent increase, and that's referred to as an automatic increase, which the park owner is entitled under the rent control ordinance.
Dr. St. John's Table 2 talks about that CPI calculation.

It appeared to me, in the petition that the residents filed, that they challenge that rent increase, but I understand, and I'm reading the homeowners arbitration brief at this point, that they're not disputing that. So if that's the case, then we won't be spending a lot of time on that, but we included the calculations there if we need to refer to them.

Then Tables 3 and 4 are the MNOI analysis done pursuant to the ordinance for 2007 and 1994, the two alternative base years.

And Dr. St. John's Table 4 talks about the temporary space rent increases, and he also provides, in Table 5, an income and expense summary.

Exhibit E is a biographical note or CV by Dr. St. John. You'll see he's extremely experienced in rent control matters. He's testified as an expert witness in many, many proceedings on rent control petitions.

Exhibit F is the CPI documents that support the numbers that were used for determining the CPI increase.

Exhibit G are property tax documents. They show the increase in the property tax, the taxes. We can look back at 1978 -- excuse me, 2008 and we can look at the bill and, I think it is, 2010 and see the increase. And we have that information presented in a couple of different ways.

Exhibit H is the Lazy Landing ground lease that was entered into and it's effective August 1st, 2008. I note it's an arm's-length transaction between the Lazy Landing and the park owner, the Bell Trust. And the primary reason for that lease is it shows two things of relevance to us here, maybe three.

First of all, it shows that the rent is 20 percent of the gross rents, and you'll hear testimony that was a negotiated number. The operator tried to negotiate for a lower number and was unsuccessful.

The second thing that ground lease shows is that the park operator is responsible for the property taxes assessed against the land.

The third thing it shows is the park operator is responsible for maintaining and making any kind of necessary capital improvements, including making sure that the park is essentially up to code for a mobile home park.

Exhibit J is the capital expense spreadsheet. Essentially what it is, is it shows a couple things. It's a nice summary sheet.

The first part shows capital expenses that have been incurred to date by Lazy Landing, or Waterhouse Management Corporation is the agent, in improvements to the park, and it lays out each one of those expenses.

Secondly, it shows the expenses incurred by the prior operator, Nomad Village, Inc., and those all essentially relate to plans and permitting that were essentially sold to the current operator so that the current operator can have the benefit of that work, and the plans cost $90,000, and so the current operators have the benefit of that.

Exhibit K are essentially the capital expense documents incurred by Waterhouse Management Corporation. Those are the backup invoices, essentially, that support the items in the spreadsheet, and Exhibit L is similar, those are the capital expense documents incurred by Nomad Village, Inc.

Exhibit N are proposals that Waterhouse Management Corporation has received to date for contemplated work. That's not all of the work that's contemplated, but it is some of it and it will show what I've gotten to date. I know the electrical work has been a little bit of a moving target and we have some revised plans and they will be updated, proposals for those. We weren't able to get them today. But it certainly shows, based upon a scope of work which is more limited than the current plans show, what the proposals are.

Exhibit N is the Waterhouse Management Corporation 2008 to 2010. Dr. St. John used those in order to prepare his analysis, Exhibit D. Exhibit D, I think, is what is going to be relevant, analytically, in these proceedings, but Exhibit N provides kind of the backup for that, and those are the financials kept in the normal course of business, and they also include the general ledger entries that show various expenses.

And Exhibit O are Nomad Village, Inc.'s, the former operator's, financials for 1994, because we used that as a base year, as well as 2006 to 2008. And again, those are summarized as to the extent relevant by Dr. St. John in Exhibit D, but those are the source materials and those were provided -- or kept in the normal course of business by the prior operator. The prior operator provided that to us so that we could use it for the hearing here.

And your Honor, that summarizes the evidence that we expect to be produced today or during that proceedings today and tomorrow and the basis for the rent increase.

THE ARBITRATOR: Thank you.

Normally what happens, I don't ask any questions during the hearing until the very end, but I do need to ask you one. The appeal tax code, the revenue from 60 to 65 you're looking at through change of ownership --

MR. BALLANTINE: Yes.

THE ARBITRATOR: -- provisions?

MR. BALANTINE: Yes. I forget the exact, but 60 to 65 is where the change of ownership provisions are and they have discussions about the change of ownership, and in one of those sections is a discussion about the fact that a long-term ground lease of 34 years or more constitutes a change of ownership, and it further provides that the termination of a lease longer than 34 years constitutes a change of ownership.

THE ARBITRATOR: Thank you.

Mr. Stanton, are you ready to go, sir?

MR. STANTON: Thank you, your Honor.

Your Honor, I'm Bruce Stanton. I'm here representing the homeowners, the mobile home homeowners of Nomad Village Mobile Home Park. As I indicated previously, I have an exact detail for your Honor of which spaces have designated me in writing to represent them, but I believe to be in the 90- to 95-space range.

We had submitted a prehearing brief some months ago as we were teed up to do this proceeding with a different hearing officer, and I think that was part of the packet that I have given, I believe, your Honor, one of those briefs this morning. I'm going to briefly summarize the homeowners' position here.

The ordinance in question clearly applies to this park which is located in the unincorporated area of Santa Barbara County. The space rents in the park where we have no long-term leases, as I understand it, that exempt any space from rent control -- all 150 spaces of the park would be subject to the ordinance -- and the rents range from a low of $287 to a high of about $430, which makes the average space rent in the park approximately $315, pending the outcome of this petition.

The noticed rent increase here that's at issue includes the annual CPI adjustment at 75 percent of CPI. 75 percent is an important percentage number under the ordinance because it's the indexing number, if you will, that the County finds to be appropriate when determining mobile home park rent increases.

The portion of the rent increase notice that requests what we would call the annual adjustment that's allowed without a hearing of 75 percent of CPI, which in this case is an aggregate of three years' worth, since, as we have heard, and homeowners agree, there's been no annual adjustment in the park since March 1, 2008, when this petitioner took control.

That portion of the notice is not opposed. There need be no further mention as far as we're concerned or proof that the annual adjustment is warranted. The petitioners are not challenging the annual adjustment.

The ordinance allows that annual adjustment but it indicates that any rent increase in excess of that 75 percent of CPI is subject to the petition rights of the homeowners, and that's in fact why the petition was filed here. I think the petition probably on its face was objecting to the entire notice, but for clarity, it's only that part of the notice that exceeds the 75 percent of CPI annual adjustment that the homeowners seek to have reviewed by your Honor in this matter. So that's the way that the ordinance works, the annual versus what I would call a special rent adjustment.

The fact that the residents here must petition is not, in my experience, unique. There are 110 mobile home rent ordinances throughout the state. A good number of them actually do put the burden to petition on the residents and they don't have automatic hearings, if you will, even when it exceeds that 75 percent of CPI annual adjustment level. But I think the way that we are proceeding today is appropriate, that the park owner would still have the burden, notwithstanding that it is technically the respondent, to justify the increase.

So that's what the ordinance allows and provides for, and I think it's clear, notwithstanding some arguments made in the initial objections filed by the park owner, that we do have jurisdiction to proceed here, the capital improvement, pass-throughs, as I would call the temporary increases, and the permanent rent increases clearly takes us above the 75 percent of CPI number, and I think that the City Clerk has verified the signatures on the petition to be correct, so I don't think there's any issue of jurisdiction here.

I think the most useful way to kind of track the park owner's request and a summary of the homeowner objections would be to lay two documents side by side, and that would be what's been marked in the binder as Exhibit C, which is a one-page sort of spreadsheet, if you will, that accompanied the rent increase notice, and side by side with that would be Table 1, which has been marked as Exhibit D in the binder that I have received today, which tracks the actual dollar amount breakdown for each of the sub-categories that appear on Exhibit C.

So if you put those side by side you can see how the numbers correlate, and it's especially important because the lower part of Exhibit C, which is labeled as "Temporary Increases" on Exhibit C, the exact dollar amount that correlates to rent does not appear, but it does appear on Table 1.

Essentially, the homeowners find this to be a very interesting and, in my experience, having done many of these hearings, a unique, if I can say, request for an increase because it has very unique and interesting components. In essence, there are some general objections and observations that we have and then some that are more specific, and I'll try to, in my opening statement, at least, talk about the more general objections.

The "Permanent Rent Increases," as Exhibit C reflects them, talk about a property tax increase and a lease payment increase. There's a pretty definitive calculation of that which just identifies an increase of $104,692 that's then amortized and gives you the $58.16 rent increase amount that's labeled as the "Permanent Increase."

The interesting thing is that this Exhibit C notice that was appended to the notice of rent increase didn't really use what counsel referred to as the MNOI analysis at all, it appeared that when the rent increase notice was created, the MNOI analysis was intended to be somewhat of a check, if you will, some sort of a verifying calculation that if we took these numbers literally and then ran an MNOI next to it, there would be verification.

Let me just explain why this is important, because the maintenance of net operating income formula is a widely accepted fair-return methodology. It's an objective methodology because it actually looks at bookends, if you will, of financial position and then adjusts for inflation so that the investment keeps pace.

So as you will hear testimony from both experts today, and Dr. Baar, on behalf of homeowners, is actually profound expert, if I can say that, in MNOI theory, is you take the base year, net operating income, income minus expenses, you take the current year, net operating income, income minus expenses and you adjust for inflation.

And in creating the net operating income calculations for the base year, the current year, not only is it important to identify a proper base year, which there will be, perhaps, conflicting testimony about in this hearing, but you're looking at what categories of income and expenses are appropriate to make up those NOI calculations in each of those two years, the bookends, if you will, that we're comparing.

One of the interesting things about this county ordinance is the MNOI formula doesn't really find itself in the ordinance mentioned as such, but I do agree with counsel that -- he, actually, I think, came up with a good word for this ordinance, I think he used the term "algorithm," which I would sort of agree with in the sense that, if that's what he meant, that this is not an easy ordinance to read through on the face of it, it looks rather complex.

But I think the intent is when looking at this maximum rent increase analysis above and beyond the 75 percent of CPI, the intent is to employ, in essence, an NOI analysis. There are in most ordinances a list of the expenses that should be included and the income categories that should be not included -- included or not included.

One of the things this ordinance, although it's not very specific, specifically sets is that any evidence with respect to amounts of principal and interest on loans and depreciation shall not be considered. And I think what that indicates is a legislative intent not to allow inclusion of expenses in an MNOI calculation that are subject to manipulation. Now, we don't have debt service expenses at issue here, but what we do have in the permanent rent increase section, the top part of Exhibit C, are lease payment increases. And homeowners' position is that no increase in these ground lease payments are a proper subject for the MNOI analysis, or for any separate, if you will, separately grounded calculation to justify a permanent rent increase.

What we essentially have is a park owner who negotiated this as part of his investment. This is an investment expense, it's not an operating expense. What we have is a situation where the rent doubled but it only did so at the time this park owner took over. There was never any prior number this park owner paid that was ever increased.

And as our expert will elaborate on, these are the kinds of expenses and MNOI calculations where circularity and manipulation is possible that would militate against including this at all in the calculation.

Once you take that expense out and run the MNOI calculation, regardless of the property tax increases, you get a much truer number of what amount the park owner would be justified in taking for what's called the permanent rent increase.

With respect to the lower portion of Exhibit C, what are called the "Temporary Increases," in the industry many times these are referred to as pass-throughs, the idea being that, as counsel explained, unlike expenses that would be added to the bottom line, added to the MNOI calculation, these are separately looked at and they're passed through for a limited period of time, based upon amortization with the idea that once the expense is fully recouped it would drop off. And state law would actually provide, and I think the ordinance also provides, that each month the rent bill that's issued by the park owner has to itemize each of those and show when it would be ending so everybody knows when they're supposed to stop paying.

So what we have are a number of categories here. Again, when you put these two documents side by side, we see that the initial category that's called "Capital Improvements," amounts to a $50.78 portion of the total of 161 -- excuse me, the total of $102.84, which makes up the combined temporary increases.

When we look at the detail for these expenses we see a number of things, and there's the exhibit that counsel referred to as Exhibit J, that shows the expense items that make up this number which is actually -- it's shown at $90,000 on Exhibit C but it's actually just below that, it's $89,211.85, I believe.

The interesting thing is that there's a large portion of this, just over $50,000, that's been paid to Penfield & Smith for engineering and surveying. But when you look at the date that all of these were incurred, we see, very curiously, that the first payment was incurred June 18, 2004, the most recent incurred, April 13, 2006. In other words, the most recent expenditure was incurred and paid over two years before this park owner ever bought the park.

So one key question is how on earth can this park owner pass through expenses that were incurred and paid for by someone else, and presumably would have been the subject of any previous rent increase applications or notices given during those years when Nomad Village, Inc., the previous park owner, owned the park.

Another important thing that stands out, and as we go through I think homeowners will need to get some itemization of exactly which of these expenses would apply to this category, but there's state law that we will cite that exempts from pass-through capability any expenses related to sub-metered energy systems within a mobile home park.

And to summarize quickly, gas and electric systems -- not water -- but gas and electric systems in mobile home parks where the park owner has taken responsibility for the interior meter and delivery system, the park owner, by taking on the responsibility, receives a monetary amount each month from the serving utility. We call that the differential discount. I'm not sure what it is down here; up north we have PGE and it's currently about $26 per space per month currently for gas and electric combined.

The idea is that the park buys the energy wholesale and sells the energy retail, and the differential to is to compensate the park for the cost of maintaining, upgrading, repairing, et cetera, et cetera, its entire system. The serving utility has nothing to do with the interior system of the park other than to read the master meter at the street.

So during the last two decades there have been cases, both at the PUC level -- one particular case that the mobile home industry calls the double-dip decision -- it's called "Rates, Charges and Practices" -- says that the park owner is fully compensated for repairs, maintenance and upgrades to the energy system by the discount and therefore is not entitled to pass any of those costs through to the homeowners.

The essence of that decision was replicated in a court of appeal case that I will be introducing as an exhibit during the hearing called Rainbow Disposal Company, which clearly states -- and it's a case that, actually, the homeowners' witness, Dr. Baar, testified in and is extensively referenced -- that capital improvement costs of over $200,000 for gas and electric improvements were properly disallowed because the PUC basically says the discount operates, or controls the field.

So as we go through this category, it's going to be important to identify what, if any, of these past incurred expenses relate to energy, sub-metered energy, and pull them out.

For the same reason, basing any capital improvements to come, and there's one exhibit, I think, where we've got this $200,000-plus electrical repair forecast, that's just not a proper subject of the ordinance, nor the hearing.

Rainbow addressed the argument directly as to whether or not a local rent ordinance could allow an energy pass-through, and said no, it cannot, very, very clearly. So all these electrical expenses have to be pulled out.

The professional fees of $50,000, to the best of what I have seen, although they are not itemized by detail to the project and the amount, it looks like a large portion or a significant portion of those $50,000 fees that are in item 3 on Exhibit C also relates to the electrical issue, so they would also be infected with the same problem.

Item 4 is called "Uncompensated Increases," and the fascinating thing about this category is that it seeks to essentially reimburse the park owner dollar for dollar for the two categories that appear up on top, the property tax increase and the lease payment increase.

And as mentioned, our position is the lease payment increase is not allowable, so to the extent that they're trying to get 34 months of uncompensated payments -- I actually calculated it and it should be 33 months, but we'll be seeing about that -- but to that extent, that would be improper.

The supplemental tax increase, the homeowners' argument is that while that increase is properly looked at in the context of MNOI, typically, going back and getting dollar for dollar recovery for three years where the park owner for whatever reason never had this kind of hearing before is simply not allowed in the ordinance. There's just no authority for that.

The anticipated professional fees relating to property taxes, which is item No. 5 on Exhibit C, the $50,000, I believe, refers to the potential appeal that counsel has referred to. Again, we just don't know anything about this. We don't know what the statute of limitations is, we don't know whether any administrative steps have been taken, whether any remedies have been exhausted. Our questions would be things like if the appeal went to the residents, get all these attorney's fees back, if the park owner can recover its fees? We don't know any detail. We don't know what the hourly charge might be or what steps were really involved. This really just appears to be a sort of, from the homeowners' perspective, kind of an anecdotal request.

And finally, the anticipated professional fees relating to the rent increase itself of $125,000, the homeowners do not disagree that it is beneficial for the homeowners to have any such fees passed through so that they are paid once and then they drop off of the rent statement. We don't disagree with those remarks that counsel made, so we are not here to say that those should become operating expenses.

However, the issue is cost, the issue is amount. What our testimony from our expert will establish is that no hearing of this nature should come anywhere close to $125,000, and that it's probably overstated, potentially, as much as three times what it should be.

So the reasonableness factor of that, which also the problem is that's completely unitemized at this point, we have no idea what that number is, or is even forecast to be, it's just a big lump sum thrown out there, that's also, from our perspective, a huge issue. As Exhibit D indicates that's a $13.80 portion of the $102.84 temporary increase.

In sum, looking at this, when you take out the ground lease payments, if those are to be excluded and if any energy infrastructure for the sub-metered system items are to be excluded, we have a significantly reduced rent increase that would be awardable and justifiable.

I think there were a few, what we saw to be and what my brief talks about, miscalculations or omissions in the first MNOI analysis we saw. I think there may have been some corrections to those, so at this point I won't speak to those any further.

But that's essentially a summary of our position, your Honor. We are confident that if the ordinance is very carefully applied, and if the law, as the reasonableness that the ordinance requires, especially with respect to the sub-metered energy and ground lease payments is properly applied, that the rent increase number, which is kind of hard to calculate, it's kind of a moving target at this point, but that it will be significantly less.

And Dr. Baar, I think, as the hearing officer will find, has extensive qualifications to talk about the MNOI and the categories that you would typically include there and the base year issues.

Thank you.

THE ARBITRATOR: Thank you, Mr. Stanton. Couple housekeeping matters. Let's go back and probably should mark the ordinance as a Joint 1. Any objections?

MR. BALLANTINE: The ordinance?

THE ARBITRATOR: Yes.

MR. BALLANTINE: That's fine.

(Exhibit Joint 1 was received into evidence.)

THE ARBITRATOR: Then the notice of hearing, Joint 2?

MR. BALLANTINE: No objection.

(Exhibit Joint 2 was received into evidence.)

THE ARBITRATOR: Okay.

Gentlemen, I've been hearing some comments that maybe some things may not be at issue. If during the break, you can run the cost of living index support, we'll get a stipulation on the record when you get back and we'll take those issues off the table.

MR. BALLANTINE: Sure.

THE ARBITRATOR: With that, Mr. Ballantine, please call your first witness.

MR. BALLANTINE: Thank you, your Honor.

Your Honor, I would like to call Dr. Michael St. John.

Your Honor, I just need a moment with my witness.

THE ARBITRATOR: Let's take a five-minute break and we'll be back on the record in five minutes.

(A brief recess was taken.)

THE ARBITRATOR: I need to make one correction of the joint exhibit. It's not the ordinance, it's the rules for hearing.

With that change, Dr. St. John, would you like to take a seat up here, sir.

MR. BALLANTINE: Your Honor, may I approach the witness and give him the exhibit book?

THE ARBITRATOR: Yes.

Sir, please raise your right hand.

MICHAEL ST. JOHN,
Called as a witness,
having been sworn, was examined
and testified as follows:

THE ARBITRATOR: Please state and spell your name for the record.

THE WITNESS: Michael St. John, M-i-c-h-a-e-l St. J-o-h-n.

THE ARBITRATOR: Mr. Ballantine, you may proceed.

MR. BALLANTINE: Thank you, your Honor.

DIRECT EXAMINATION

BY MR. BALLANTINE:
Q. Dr. St. John, what is your profession?
A. I'm an economist.
Q. Can you tell us a bit about your background in becoming an economist? Start with educational background, please.
A. Yes. I went to UC Berkeley and got a master's in economics in 1984 and Ph.D. in economics in 1989.
Q. And tell us, did you have an undergraduate degree before going to Berkeley?
A. I had a B.A. from Harvard College.
Q. All right. And as an economist, have you focused your area of study in any particular areas?
A. Rent control, one could say.
Q. Okay.
A. My dissertation was on the effects of rent control on property value.
Q. Tell us a little bit about your academic experience in the area of rent control studies.
A. There are no courses in rent control at graduate schools, so I studied microeconomics, I studied regulatory economics, but there was no coursework explicitly on rent control.
Q. Have you, then, either during the course of education or subsequent to that, performed any studies

and written any scholarly reports on rent control issues?

A. Well, the major study that is relevant to these proceedings is a paper that I did initially, I think it was 1993, called "Fair Return Under California Courts." It was a comprehensive analysis of the principle of fair return as it is applied in a regulatory context in California with applicability to various lawsuits and cases.

Q. And was that particular study focused on mobile home rent control?

A. It was focused on mobile home rent control. It's fully applicable to both mobile home and residential rent control, but, yes, it had a strong focus on mobile home rent control.

Q. Have you also done -- have you done particular work in the mobile home rent control area?

A. Yes. I have appeared, as I'm appearing today, in cases. I've also been hired by cities to advise them on fair return issues --

Q. So -- I'm sorry.

A. And I'm just thinking, I don't have my bio in front of me, but I also was hired in several of the key lawsuits, the Cotati suit, for example, and others that had fair return implications.

Q. And speaking of your bio, let me direct your attention to Exhibit E in the binder.
A. Yes.
Q. And we've got a biographical note. Is that a biographical that summarizes your work in the rent control area?
A. Yes.
Q. Yes.
A. You know, when I came up to this stand I didn't bring my glasses and it would be very helpful if I got them.
Q. Go ahead.
A. All right.
Q. Okay. Now that you have your glasses, does Exhibit E look familiar?
A. Yes.
Q. This is a summary, the first page, biographical note, is that a summary of some of your background and experience in rent control?
A. Yes, it is.
Q. And I think this is the biographical note from the article you just referred to, "Fair Return Under California Courts."
Then the next page and the following pages, is that, essentially, your CV?

A. Yes, it is.
Q. So you've served as an expert witness in mobile home rent control proceedings, is that correct?
A. I have several times.
Q. And you have also been hired as a consultant for municipalities?
A. Yes.
Q. Has that been in the area of mobile home rent control as well?
A. Yes. I was about hired by the City of Lancaster, I was hired by the City of Marina, and by -- I can't recall if it was the City of Santa Rosa or Sonoma County, they have combined rent control system and I don't remember which one of the two hired me.
Q. Okay. And you indicated you appeared in a number of key lawsuits relating to mobile home rent control?
A. That's true.
Q. And you listed some of them here on the last page of your CV?
A. Yes, that's true.
Q. Are you familiar with what Mr. Stanton was talking about, the MNOI analysis, are you familiar with that?
A. Yes.

Q. Tell us about what, what does it stand for?

A. MNOI stands for maintenance of net operating income. It's sometimes BYMNOI, which would be base year maintenance of net operating income.

Q. And is that a system that's utilized sometimes in mobile home rent control?

A. It is.

Q. Tell us a little bit about that in general.

A. The MNOI system is a creative system to approximate a fair return. It's not, technically speaking, a fair return on investment system, but it's a very good approximation that is now, thanks to Dr. Baar's work, it's now in current use throughout California.

It is easier to use than strict fair return on investment systems. The numbers are easier, the calculations are easier and, as has been mentioned, it's not subject to manipulation in the way that fair return on investment systems conceivably might be.

Q. Describe for us a little bit of the difference between the fair return on investments versus the MNOI system.

A. Well, the typical fair return on investment system, one actually uses the investment amount and the rate of return, would do the math and would say the park owner deserves that rate of return, depending on fair rates of return. In other words, it would be a rate of return analysis. There are several varieties of that, but in a nutshell, is what a fair return on investments system would look like.

The MNOI system, on the other hand, extrapolates from that and deals only with the income, the expenses, and the net income in a base year on one hand and in a comparison year on the other hand, something I think Mr. Stanton referred to as the two bookends, and that's correct.

Q. So the MNOI analysis is focused solely on income and expense?

A. Correct. And I should say that having been used in many, many case, many jurisdictions, it's a system that is well worked out, the details are well worked out as to what should be allowed and disallowed.

In a moment, when we get into it, I'll be explaining the elements from the books of record that were disallowed in an MNOI context.

Q. So essentially what you're saying is when you do an MNOI analysis you go in and look at the books and records and certain expenses you consider income and expenses and certain income and expenses you do not consider when performing that analysis?

A. Right. I mean, books of record often include things like, for example, depreciation. Depreciation is not actually cash, it's a tax item. And people, bookkeepers will put it into the book of account as if it is an actual expense where it isn't, so I take it out and Dr. Baar would take it out, too, I believe.

Q. Would it be fair to say you're very familiar with how to perform an MNOI analysis?

A. Yes. I do them often.

Q. And since we're talking about it in general terms, let me ask you this, because one of the items that we'll be talking about in greater detail is the ground lease expense. Are ground lease or rental expenses incurred by operator, are those typically included in an MNOI analysis?

A. Yes, in my experience they certainly would be.

Q. Ground lease expenses are included?

A. Yeah, it's an expense. Ground expense would certainly be an expense from a bookkeeping point of view, it's a cash expenditure, it would be an expense from an auditing point of view, it would be an expense from an IRS point of view, a tax return would certainly include it, and it would be allowed in all those contexts, and it should be allowed in an MNOI context as well, and has been in my experience, many times.

When I say "many times," I don't say all the time only because most parks are owned by the operator. There are some parks, like Nomad Village, where the operator doesn't own the park, it leases the park, so it's relatively rare that ground leases appear at all, but when they exist, then they do appear in the MNOI analysis.

Q. We're here in Santa Barbara County. Have you reviewed the Santa Barbara County Mobile Home Rent Control Ordinance?

A. Yes.

Q. Let's talk about the ordinance a little bit. Does it prescribe, does it have certain provisions that tell us how mobile home rents are to be determined?

A. Yes.

Q. It's a fairly broad question, so I guess I'm looking for kind of a broader explanation. Tell us a little bit about the ordinance, how it works.

A. Okay. It's a little bit unusual ordinance. I refer to it as a fair return system, as an MNOI system, but to keep our language clear here, I'm going to start calling it the "Santa Barbara Ordinance System" or I might call it "Santa Barbara MNOI." It's the Santa Barbara variation on what I would call, in contrast, the classical MNOI.

There is a classical MNOI system which was articulated by Dr. Baar in his 1983 paper and by me in the "Fair Return in the California Courts" paper that I referred to, and the Santa Barbara County system is slightly different. It's still what I would call an MNOI system, but it has a difference which I can explain, if you wish.

Q. Yeah, I guess this could be a good time to do it. Compare and contrast the classic, as you call it, MNOI analysis versus the Santa Barbara County ordinance you've described as kind of a modified MNOI analysis.

A. Well, the Santa Barbara ordinance is quite specific as to what an arbitrator is empowered to do and is not empowered to do in this context, the rent increase.

It says that the arbitrator is --

THE ARBITRATOR: Hold on. Off the record.

(Discussion off the record.)

THE ARBITRATOR: All right.

MR. BALLANTINE: I'm going to back up. I think he was starting to answer but I'll back up for the record.

Q. Dr. St. John, I was asking you if you would please compare and contrast what you termed the classic MNOI analysis versus the Santa Barbara County ordinance system which you've kind of characterized as a little bit of a hybrid or variation on the classic MNOI analysis.

A. Right. The Santa Barbara ordinance system instructs the arbitrator to do what I'll call the CPI calculation, and then cut it in half, to award half of the CPI as a fair return and it says that the arbitrator has -- doesn't have authority to grant any more than that as a fair return. And then it says that the arbitrator should grant the other half as an expense compensation and doesn't have authority to grant less than that as the expense compensation, and then encourages the arbitrator to consider the expenses as they may have increased over time, and if the expenses have increased over time by more than that portion the second half of the CPI increase would allow, then the arbitrator is to allow the remainder.

Q. So the last portion that you spoke of was that the arbitrator consider specific expenses that had increased from the base year that you're using?

A. Right, right, the last portion is the specific evaluation of base year to comparison year expense increases.

Q. And does the ordinance specifically identify as a property tax -- increased property tax expense as one of those expenses to consider for the purposes of a rent increase?

A. I believe it does.

Q. Does the ordinance have any provisions precluding the consideration of a ground lease expense?

A. I don't think so, no.

Q. In your opinion, would the inclusion of a ground lease expense be an appropriate expense to consider under the methodology that's set forth in the county ordinance?

A. Yes, I see no reason to exclude it.

Q. Does the ordinance also have provisions regarding capital expenses and improvements?

A. It does.

Q. Tell us a little bit about that.

A. Well, again it's a little unusual. It does allow capital expenses and capital improvements, and they are distinguished in the way that capital expenses and capital improvements are often distinguished from each other in these sorts of matters.

It says, and here's the unusual part, it says that capital improvements can be noticed in advance and that the park operator is required to begin the work within six months and if he doesn't he has to give a refund to the residents.

I can't recall at the moment ever seeing that provision in another ordinance, but that is a provision of the Santa Barbara ordinance.

Q. All right. So for that one, that's the idea, that those expenses can be noticed and sought and collected in advance of actually incurring the expense and doing the work?

A. Yes. But the presumption clearly is that the work is really going to be done. There's no sense here that a park owner could fail to do that work and still get compensated. It's only a matter of the timing, and it kind of says that the park owner can begin charging up front rather than -- in some ordinances, the park owner wouldn't be allowed to start charging until later, but since these are amortized, and the ordinance is clear about amortization with interest, it really I doesn't matter if it begins -- I mean, I shouldn't say it doesn't matter exactly, but the amount the residents will pay isn't greater under the Santa Monica ordinance method, which starts the increase a little earlier, because it will still run for only whatever time period it is, let's say seven years. It will run seven years. If it were to start later, it would run for seven years but starting a little later. So it matters, but it doesn't change the amount.

Q. And that's the Santa Barbara ordinance you're speaking of specifically?

A. Yes.

Q. With respect to the ordinance, does it also have a provision that says if the park owner no longer incurs an expense or ceases incurring an expense for which it has received a rent increase, then the park owner is to essentially reduce the rent by a pro rata or according to that reduction for the expense not incurred?

A. You're speaking in terms of capital improvements?

Q. Anything.

A. I'm not recalling the provision you're reciting.

Q. Maybe it is specifically capital improvements.

A. Uh-huh.

Q. We can come back to that.

Let me ask you a little bit about what you did in this particular case. Did you do some work on helping to determine the appropriate number for the rent increase at Nomad Village?

A. Yes.

Q. Can you just give us an overview of the types of things you did and then we'll get into the details of the analysis, but give us the forest for the trees.

A. Well, the first step was to simply acknowledge that there are two very major cost increases that occurred since purchase. The first, as has been said, being the property tax increase, and the second being the lease increase.

Q. And that's one incurred expense at the time the new operator took over operations?

A. Yes, both of those occurred basically in 2008, at the time of transfer from one operator to another. So the first thing that I paid attention to was -- this is reflected in Exhibit C -- is how much of a rent increase might those two big items actually warrant.

The MNOI process is kind of complex and I thought that it would be useful for everybody -- owners, residents, and so forth -- to see in kind of a one-page presentation what this was all about. So Exhibit C was to get on one page what often is many pages. And now, of course, it is many pages now, and that's okay, because now we're in an arbitration setting, but at the time of the rent increase, the effort was to try to get it simple enough so that everybody could understand.

Q. And that reminds me. Let me ask you one other question about the Santa Barbara County ordinance overall. You testified a few minutes ago about a specific procedure that the arbitrator is to follow regarding making its determination as to the amount of rent increase that's appropriate in this circumstances. Do you recall that discussion?

A. Oh, yes.

Q. In the language of the ordinance itself, is that specific to the arbitration proceeding and the arbitrator?

A. That is specific to the arbitration proceeding as I understand it, yes.

Q. In other words, is there a specific language in the ordinance that says if a park owner is going to give a rent increase that the park owner must initially follow that procedure for noticing a rent increase?

A. No. As I recall the ordinance, and I have read it many times, the ordinance says that if a park owner needs a rent increase, wants a rent increase, then he notices it. And the requirement, the only requirement, other than it be clear and it be noticed correctly, is that the park owner make available to the residents books of record for the past four years. So we did that, and that appears as Table 5, as I recall, in the books we have here.

But Table 5 doesn't have any analysis, it's not adjusted in any way, I didn't manipulate those numbers, that's just a matter of getting the books of record from the current operator and the old operator and then putting them down in consistent format on one page -- well, it's actually more than one page now, but putting them down in one spreadsheet so that they can be compared year by year by year so they make sense.

But we didn't really do an analysis. That Table 5 doesn't lead to a conclusion as to what the rent increase might be, but it does allow myself or Dr. Baar or anybody else who looks at these numbers to look back, not merely four years, actually, we went back five years, from 2006 to 2011, and the reason I thought we should put in all of those years, one more than we were required, is if the base year is going to be 2007, then it's useful to have a bracketing years, 2006, 2008, so that people can look and see was there anything unusual about 2007.

This ordinance, like many ordinances, says if there's anything particularly unusual about the base year that the arbitrator can make adjustments. So having those years that surround the base year we've chosen -- we'll get to that in a minute, I'm sure, about the choice of base year, but having those years that surround it is useful because someone might say, oh, the figure for administration was too high that year, or too low, and this allows anyone to take a look and see, is it comparable, roughly comparable to other surrounding years.

Q. All right. You were starting to tell us a little bit about the calculations you did, I think referencing Exhibit C, the effort to put on one page an explanation of how the need for a rent increase was factored in and how the number was derived?

A. Yes.

Q. All right. Is there anything in the ordinance that prevents this Exhibit C from this methodology?

A. Well --

Q. For the purposes of noticing a rent increase, to start off with?

A. No, no, I don't see why there would be anything in the ordinance that prevents this particular format. Is that your question?

Q. Yes.

A. I think the format is perfectly -- as far as I know, the format is fine. There's nothing wrong with the format.

THE ARBITRATOR: If I can ask the witness to please wait until the question is fully asked before you answer.

THE WITNESS: Thank you.

BY MR. BALLANTINE:

Q. Let's go through Exhibit C a little bit and talk about the details. Why don't you take us through it a little bit. Let's talk about the permanent increases and the property tax increase.

A. Okay. The first step was to sort out from the property taxes the sewer fees because they happen to be billed on the property tax bill, so these, at the top there, you see for 2008 and 2009, $50,145 in the case of 2008, and $54,588 in the case of 2009, subtract it out in order to get to C, what the taxes were, just the taxes. And in 2008, the taxes were $20,453, and in 2009 they were $66,523, an increase in that time period of $46,070.

Q. Okay. And did you look at source documents in making that determination?

A. I did, I did. I downloaded from the Santa Barbara County website the tax summaries and then, later on, I got actual copies of the tax bills, I compared them, they were comparable -- they were the same, actually, the County's records were accurate -- and I also consulted, of course, books of record.

There was some complexity because taxes are billed on a fiscal year basis, taxes go from July 1 of one year through June 30 the next year. That's the way they're billed, but they're paid in certain calendar years. So, for example, in 2009, typically, a park would pay, early in 2009 they would pay the second half of the 2008-2009 property tax bill, and then later that year they'd pay the first half of the 2009-2010 property tax bill. So the amounts that are paid, the actual checks that are written don't exactly match the amounts billed, and so that's a complexity that has to be worked out.

Q. Did you work out that complexity?

A. I did work out that complexity. It all comes out in the end.

Q. All right. I interrupted you there. I apologize.

Did you make a determination in consulting the books and the records and making the appropriate analysis that the taxes that you're basing the rent increase off were actually in fact paid?

A. The taxes, as far as I know, the taxes were paid. They're in the books of record. I'm assuming the books of record are correct.

Q. And did you make a determination the taxes were paid in the amounts that you have booked here for this spreadsheet?

A. Well, you know, I would have to look because, from what I just said, these are tax bills and sewer fees and, therefore, taxes. These are those fiscal year summaries. In effect, these amounts of taxes surely were paid, but they were not paid in these amounts. I don't think you'll find a check for $20,453 in the books of record anywhere because the amount that was paid in 2008 would have been half of the 2007-2008 bill and half of the 2008-2009 bill, so it would have been slightly different. It doesn't make much difference year by year by year because the taxes only go up by 2 percent, but it makes a big difference between, for example, 2007 and 2010.

Q. Okay. And you did determine taxes were actually paid by both operators, is that correct?

A. I did. The taxes were paid.

Q. And that gives us a number, you said, basically the $46,000. And then did you do something to essentially make that part of the rent increase?

A. Well --

Q. What would happen?

A. For purposes of Exhibit C, I simply did the math and put the amount, $46,070, and then continued down the page and did the other elements.

Q. Okay. And let's address one thing that came up in opening. You have a note regarding No. 1 -- well, regarding the property tax increase, and the note is the No. 1, correct?

A. Yes.

Q. And tell us about that note.

A. Well, let's see. This is a form I created a long time ago. "Property tax increase will be challenged." Well, I can't say that on my own authority. I'm just repeating there what you told me, which was it was possible for the tax increase to be challenged.

Q. Fair enough. Go on.

A. If the challenge is successful, this amount will not be passed through to the residents. I guess I just wanted the residents to know that this was an item that might be mitigated later.

THE ARBITRATOR: Counsel, would you approach, please.

Off the record.

(Discussion off the record.)

THE ARBITRATOR: All right, let's proceed with the questions, Mr. Ballantine.

MR. BALLANTINE: Thank you, your Honor.

Q. We were talking about this property tax increase. Summarizing, Dr. St. John, would it be fair to say that in the spreadsheet that you prepared, you were signalling to the residents that there was a challenge to the property taxes that was contemplated being pursued, and that if that challenge were successful then the rent increase amount would not be passed through to the residents?

A. That's right, that's what I wanted to convey.

Q. You also convey that in meet and confers with the residents as well?

A. Oh, yes, we talked about that.

Q. All right. Let's go on to the next item here in Exhibit C, No. 2. You've got lease payment increase. Tell us about that.

A. The lease payments under the old management was 10 percent and under the new it's 20 percent. And doing the math, you can see the lease payments approximately doubled. So that indicates, since, in my view, ground lease payments are a legitimate item of expense in MNOI calculations, that there should be a pass-through of $58,622 to compensate for that increase. That is a cash amount that the park is paying that's greater by that amount than what's being paid in 2008.

Q. All right. And a couple of questions on that. One, did you look at the books of account of both operators and determine that those amounts were being paid?

A. Yes.
Q. And with respect to the increase, did you perform an assessment and determine that that was an appropriate expense to pass through to the residents?
A. Yes.
Q. And that would be under the applicable ordinance?
A. Yes.
Q. All right. So would it be the case that you determined these two items and you got a number, the $104,000, and from that number you came up with what that would work out to be as a specific rent increase per space?
A. Yes. And I should point out that Table 1 gives the per-space-per-month analog, and had I thought about it at the time, I would have put on this chart, but I didn't. Actually, at the meet and confers, as I recall, the residents asked that I put it on this chart and that's why our -- it is shown on the current tables that we're using.
Q. And by that you mean, that would be just the sub-breakdown between, for example, what we've looked as permitted items 1 and 2, is that correct?
A. Well, I'm just talking about the fact that column H on this page, Exhibit C, just gives the dollar

amount and for residents to know what impact that has on the actual rent increase, you have to turn to Table 1.

Q. Now, you do have, though, a permanent increase, a total number per space per month down on line 42 under column H, correct?

A. Yes, it's there for the whole thing, but it is not there for the line items.

Q. For the line item, right.

But we can see that in Table 1?

A. Yes.

Q. And we'll look at that in a second.

So basically, you've got a $58.16 per month per space increase, permanent increase based upon these two items up at the top, 1 and 2, the property tax and the lease payment?

A. That's right. The math of it is simply the figure $104,692 divided by 12 months and by 150 spaces, gives you $58.16.

Q. Thank you. Let's go down to temporary increases. Tell us about how you did the calculations for the capital improvements.

A. Well, can I ask your question this way? First, talk about the amortization as a general category. Do the amortization calculations apply to items 3, 4, 5 and 6? So the ordinance makes it clear that for capital improvements amortization is appropriate, and what amortization means is spreading the cost item out over several years and then having it terminate then at that time.

The ordinance also says that it's to be done at interest, that the interest should be included. So the question was, what rate of interest is appropriate and what number of years is appropriate, and both of these are debatable. It could have been a different number of years, could have been shorter, could have been longer, could have been a higher rate of interest, lower rate of interest. Nine percent seemed to me like a reasonable rate of interest in these contexts, and seven years seemed like a reasonably average time period.

I've seen amortization periods considerably longer and some somewhat less. Residents, interestingly enough, sometimes argue for shorter rather than longer because residents understand that if it's amortized out over a longer time period they're going to pay more interest in the long run and are therefore willing to pay a larger amount sooner in order to have a lower amount later. But some residents don't feel that way and they want the lowest dollar amount possible right now. So these things are debatable and they are often debated, but 9 percent and seven years seemed like an average kind of figure to use.

The ordinance, by the way, doesn't specify either one. They don't specify what rate of interest and they don't specify how many years, so we really don't have much guidance. Some ordinances do. Or in some jurisdictions, there are rules or regulations that spell out the amortization periods, but that is not true for Santa Barbara County.

Q. Would it be accurate to say you used your professional judgment and experience in this area to come up with a number that you thought was appropriate?

A. Yes, I was going to go on to say that figure in column H, $91,398, is the number that the computer generates when you tell it to amortize $460 at 9 percent over seven years. So the actual calculation is kind of hidden from view, but that's the number that is produced.

Q. I take it, though, the calculation that you reference is based upon the rate that you do put there, the 9 percent and the number of years there at seven?

A. Yes.

Q. And then just to go through the component numbers, the A&E fees, those were provided to you as the amount that the prior operator had incurred during planning and permitting?

A. That's right. The $90,000 for A&E, the $50,000 for professional fees and the $320,000 for infrastructure costs were all given to me, and that's why I put them down there.

Q. For the infrastructure costs of $320,000, did you also see a statement -- let me have you look at Exhibit K.

A. Yeah, I've seen this statement.

Q. The Berkadia statement, were you provided with this as the amount of money that currently had been paid into an escrow as of this date?

A. Yes, this was January of 2011, and it says up top the reserve balance in this account was $327,000 and change.

Q. All right. And the operator told you that's money they have escrowed for capital improvements to this park?

A. Yes, it's my understanding this is in an escrow account.

Q. All right, so we've looked at those three figures. Let's go down item 4 down the sheet, "Uncompensated Increases." Tell us about those.

A. Well, the tax increase computed at the top is $46,070 being incurred at the time that the park came under new management.

Q. And that was August 1st, 2008?

A. I think it was August 1st, 2008. I don't remember exactly but basically August of 2008, yes.

And the County isn't quick, usually, in changing the tax rates, they wait a while and then they eventually change the taxes and then they send our supplemental tax bills. So I use the term "supplemental," but that's not -- I don't mean to say the supplemental tax bill, I mean to say that the extra, the increased tax amount was $46,070 between 2008 and 2009.

Then the question is, how long will it be before the park owner begins being compensated for that tax increase? And the answer is, until May 1, 2011. The increases that were imposed, effective May 1, 2011, covered that amount, so from then forward the park owner is whole, but for the period from August 2008 to May 2011 the park owner was obligated to pay these amounts but the residents were not obligated -- before this proceeding, or otherwise, wouldn't be obligated to pay it.

But in my view, these are amounts that residents, in the end, have to pay. This is an increase, it's a legitimate increase, it's government imposed, it's not within the park owner's discretion, it is an extra cost.

So I think Mr. Stanton might tell us, maybe he did, I don't know, oh, well, you should have petitioned right away. Well, okay, but that would imply that we have to petition kind of for every year, every single time an increase comes up we're going to have to petition, petition, petition, and these petition processes are quite time consuming, if you don't know. And so to my mind, it simply does not make good sense to, in effect, command the park owners do an entire NOI fair return petition every year. That doesn't make good sense, and the way to not do that is to allow park owners to do this kind of a fair return hearing periodically, when appropriate, when it feels appropriate, and then to be compensated for -- to be compensated after the arbitrator has decided on the justification for the increases in question, to be compensated for the past. The topic I'm addressing here is really known in the literature as regulatory lag.

Q. Regulatory lag?

A. Regulatory lag. And the PUC knows all about it, and PG&E and the other electric utilities and the other utilities, they argue this all the time, and they talk to the PUC and they say, wait a minute, you're giving us an increase from now forward, but what about the time in the past? And it's my understanding that normally some adjustments are made in order to cover the time in the past when some costs may have gone up by an unusual amount.

Well, the increase in property taxes by almost $50,000, that's certainly an increase in an unusual amount. It's a heavy expense that the park owner has been incurring ever since 2008 and that's why, in my view, there should be this extra amount.

But then the question comes, how are we going to ask residents to pay this back? And again, it could be paid back all in one year, and this happens under some ordinances, that it is paid back all in one year, but that would be a pretty heavy burden on the residents. It becomes a lighter burden on the residents if we amortize it, so there's a judgment call here as to how to handle it.

I mean, the first judgment call that the arbitrator will be considering is whether it should be allowed at all in this matter, but the second question is how should it be done, should it be done more quickly or more slowly. Partly for ease of computation, and I did all of the amortizations on this page using the same rate, 9 percent, and the same number of years, seven years, and people could have differing opinions for each of these items, No. 3, 4, 5 and 6, and it would not be hard to adjust the amortization calculation for each of them if we were to decide that some different time period or rate was appropriate, more appropriate for one or another or all of them. I can't say that there's anything particularly appropriate about 9 percent and seven years for item 4, but it seems like an amount that the park owner is willing to agree to and so I'm approaching it that way.

Q. Let me break down what you have said on that to make sure I'm clear and we're all clear on the calculations.

So essentially, the concept is for uncompensated increases and solely addresses the issue of the permanent increases, the property tax and the lease increase, and it covers the gap in time from the time that the park owner first started incurring that expense to the time that the park owner or operator was able to recover those expenses in the form of a rent increase which started on May 1 of this year?

A. Right.

Q. And in terms of regulatory lag, essentially, that's the difference between the time that the park operator first incurred the number to the time that it could go through the regulatory process and begin recovering that cost. Is that a fair summary?

A. Yes.

Q. So let me make sure I'm clear on the numbers. If you look at starting with the supplemental tax increase, you've got in column E-28 there, the $46,060, and I take it that's just your annual number that you brought down from -- your annual increase number, I should say, that you brought down from column H-8 above?

A. Yes, H-8.

Q. And then that's just a table, that's a -- that's just a cell-to-cell kind of --

A. Yes, uh-huh.

Q. And next to that you've got "Monthly," and I take it you just took the annual increase and broke it down to see how much that was per month, that increase?

A. That's right.

Q. And then you multiply that number by the 34-month gap and you got a total of $130,000?

A. Yes.

Q. All right.

A. Can I interrupt to say, Mr. Stanton said he thought it was 33. He could be right. I wasn't 100 percent certain what the date -- when I did this calculation, I wasn't 100 percent certain what the date of transfer was so I didn't know when the property tax -- the taxing authority would begin, and so we could revisit that question as to whether it would be 33 months or 34. I'm not able to tell you at this moment for sure that it's 34 or 33.

Q. Well, it's one month. But looking at the number as a total, the outcome of the actual increase, the bottom-line number to the residents, is that a significant difference?

A. No, it's not, I don't think it's a significant difference.

And just to complete the math, so we take the 34, in this case, and we multiply it by the monthly, and that comes out, in the case of the tax increase, to $130,531.

Q. And then essentially your process was absolutely identical, then, for the land increase, correct?

A. It was. And just to state it again for clarity, this $130,531 tax increase is the amount that the park owner really did pay, I mean that's actual out-of-pocket, $130,000 and change without being compensated at all, whereas under the system we're using here, park owners deserve compensation for cost increases.

Q. And actually, it's fair to say that that is -- even more specifically to say, that's the amount of increase that the park owner is out-of-pocket. In fact, the park owner is out-of-pocket more than that in the total property taxes, that $130,000 is just the increase number for the period of time in question?

A. Yes. I mean, I would only say the rest of the property tax amount was covered by the income, by the space rents, but this amount is not covered by space rents and should be.

Q. Okay. And then again I was asking you, essentially you'd say the same thing about the land lease increases for that period of time, correct?

A. That's right.

Q. And so that gets us to a number almost $300,000. And you took that number, basically amortized it over seven years, applied a 9 percent interest factor and you got a number of $58,937?

A. That's right. And anyone with a spreadsheet program can repeat these calculations and make sure that I did it correctly.

Q. Right. And the tenants have had these since January or since around that time, February?

A. Yes.

Q. And actually, although I'll just jump to Table

1 quickly just to compare that, you also, then -- Table 1 is the same thing or the same concept, the same information as Exhibit C, this just gives us a breakdown per space per month of these sub-items, correct? So in other words, under "Uncompensated Increases," that comes out to roughly $32.74 per month per space on that sub-item?
A. Yes.
Q. All right. So does that mean if we're off by a month, 33 instead of the 34 we were working with, you'd have something in the neighborhood of a dollar?
A. Yeah, that's right, it might make a difference of about a dollar.
Q. All right. Let's move on, then. But just so I'm clear, so this No. 4, the total, that we did this with a sub-number as part of the $102 rent increase pursuant to the notice?
A. Yes, it's one component, one of four pieces adding up to $102.84.
Q. In your professional opinion, was it appropriate for the park owner or the park operator to recover this, essentially, this regulatory lag?
A. Well, I think so. I mean, I can see that some people might think not, and it could be debated, but yes, I think so for the reasons I just explained.

You know, there's always regulatory lag in amortization in almost all ordinances, all jurisdictions, almost always between one year and the next, at least. And that is something that we simply accept because it takes a while for the CPI statistics to be calculated, for the government to give you those numbers, it takes a while for the books and records to be accumulated. We can't bring a fair return application until after the completion of what is going to be the comparison year, and as we see, we're now in September and we're working on numbers from 2010, so nine months have already elapsed. During those nine months, it's highly likely that expenses of the park have increased. Inflation is not wildly high these days but there is inflation, so it's unlikely that the park -- it's likely that the park is paying yet more in expenses today.

So these are all of the conditions and regulatory lag, and it's one thing when it happens one year, but when it happens several years and it's accumulated, then it gets to be more than is appropriate, especially when it's on a big item, which is why, in my view, these uncompensated increases should be handled in this way.

Q. All right. Let's go down to item 5, then.

That's the uncompensated or the anticipated professional fees relating to property taxes and the $50,000.

Was that the number that you were given as to what would be the retainer fee in the event the park owner pursued property tax litigation?

A. Yes.

Q. And how did you treat that?

A. Much the same as the other two I mentioned, as item 3 and item 4. I simply amortized that number over seven years at 9 percent.

Q. All right. And would the answer be similar regarding No. 6, anticipated professional fees relating to the rent increase? Was that a number that you were given as the number that would be -- that was an estimate of what the retainer amounts would be in the event that rent increase from the time of actually calculating the rent increase and preparing the notices through full-blown litigation would amount to?

A. It is the number I was given.

But can I return for a moment to item 5?

Q. Yes.

A. I want to say a little more about that. In my experience, if an amount like $50,000 were to be incurred in one calendar year, and if that turned out to be the comparison year for an application in this jurisdiction or any other, Dr. Baar, I fully believe, or any consultant for the homeowners would probably object. They would say no, no, that's too big. It's an unusual item and you can't -- you shouldn't leave it in the calculations because that means that, in effect, the arbitrator would be adding that amount to the budget for the park for every year thereafter. And I would basically agree with that judgment. So the shoe is on the other foot. We're talking now about --

Q. Let me interrupt you. The analysis you were just talking about, so we're clear, you'd be talking about an MNOI or an MNOI-type analysis for the purposes of contemplating or calculating a permanent rent increase?

A. That's right. And let me make my hypothetical a little different and maybe a little tighter. If we actually did this and, let's say, we spent $50,000 in 2012 on the property tax issue, and let's say in 2013 we apply for remedies. I'm saying that Dr. Baar, if he was a consultant at that time for the residents, he'd probably say that's too much, you can't do that all in one year, it should be amortized, and all I'm just saying is yes, I agree with what I think he would say, that it should be amortized and therefore, instead of putting it into the -- well, what I'm saying right now, actually, is more appropriate for item 6. But instead -- I'll just finish what I was saying. Instead of putting it into the budget wholly unamortized, I'm suggesting that we amortize it. I'm suggesting that in advance.

In category 6, for example, some piece of this $125,000 were incurred in 2010. They were fees paid to myself for doing the calculations here, and some other amounts were paid, I believe, to the park's attorney for work he did in preparation for this hearing.

Now, if those amounts were to be put down, some of those amounts occurred in 2010. If those amounts were put down in the budget, again the implication would be that those amounts are going to be recurring year after year after year. Most expenses do recur year after year after year and they vary a bit but they recur. And I believe, had we done that, Dr. Baar would have probably said, no, that's not really right, you can't do that.

So anticipating that conclusion, which actually I agree with, we pulled them out -- we'll get to this in a minute and I'll be able to show exactly where we pulled them out and how much -- I'm just trying to explain why some expenses are amortized, and partly I'm explaining this because the ordinance doesn't talk about amortization in this manner. The ordinance actually doesn't lead us down this road.

The ordinance -- it's one of the shorter ordinances. It doesn't go into as much detail as some ordinances. So when we sought out these items, particularly 4, 5 and 6, I wasn't 100 percent certain how they should be handled. They could have been simply addressed as cash items and put in the MNOI in the normal way, but that just didn't seem right, so some of these amounts were related to prior years, some of the amounts related to future years, some related to this year, and all of those amounts were taken out, summed, and treated by analogy to the way the capital improvements are treated.

They're not capital improvements, that's true, but they are large expenses that shouldn't be treated simply as an annual -- an annual cost item.

Q. So in your professional opinion as an economist with experience in mobile home rent control and your reading of the ordinance, is there anything in the ordinance that precludes the treatment that you gave to items 5 and 6?

A. I don't think so, I don't think so.

Q. Essentially, you made a distinction between either treating it as a normal operating expense, treating these expenses as a normal operating expense for the purposes of calculating a permanent rent increase under MNOI or pulling it out and making it something separate, essentially. Is that correct, a fair distinction?

A. It is a fair distinction.

Q. And let me ask before we go on with the analysis, in your professional opinion is it appropriate to include in some manner for the purposes of rent increase under a mobile home rent control ordinance, expenses of this type that a park operator would incur -- for example, legal and appraiser and other professional fees relating to property tax litigation and to rent increase hearings and litigation?

A. Yeah, I do, I think that it's appropriate.

Q. So to start off as a basis, you think the type of expense we're talking about is an appropriate expense to be included in some way in a rent control space rent increase?

A. Oh, completely, I do think it is. And parenthetically, if I can just say, if these amounts were to be included in the MNOI and if the arbitrator were to ask me or Dr. Baar to compute it that way, it would come out less advantageous to the residents. So --

Q. And the reason for that would be because if you included it as a MNOI analysis, or a similar type of operating income analysis for the purposes of a permanent increase of rent, you'd essentially have an extraordinary expense being deemed to being a normal operating expense and it would essentially be forever, become a permanent rent increase that would go on forever for the residents and would be based on what arguably would be a fiction -- that is, that this extraordinary expense is really a regular recurring expense?

A. Correct.

Q. So what you're saying is by treating it this way as a temporary increase, it's more fair to the homeowners?

A. That's right.

Q. Okay. And I think our comments related to both 5 and 6 as to that?

A. Yes, I was speaking about 5 and 6 kind of together.

Q. All right. And essentially the bottom line is we see the four items, 3, 4, 5 and 6, those are the sub-components of the temporary increase that you determined totaled to $102.84?

A. Yes, on an amortized basis, $102.84.

Q. And it's all using a common amortization period?

A. Yes.

Q. All right. Why don't we move on, then, to the Exhibit D and just ask you a few general questions. Is Exhibit D a group of documents that you prepared?

A. Yes, I prepared all of these.

Q. I think we've more or less talked about Table 1. Essentially Table 1 tracks Exhibit C, it's just all you have essentially done is broken down the temporary increases by -- we already had an overall per space per month, but you broke the subcategories down per month?

A. I think it's useful for all of us to be able to see how much each of the line items contributes to the total.

Q. Thank you. Let's go on to Table 2. And actually, Table 2 is -- this shows the CPI calculations that you used?

A. Yes.

Q. All right. And we've got some, I think, backup of the CPI indices that were used in another exhibit, but let's move on. I don't think that's really an issue here.

Let's move on to Table 3-A and 3-B, which are two groups of tables here comprising several pages. Can you tell us what those are?

A. Yes. This is what I call MNOI analysis or, more accurately, I should say the Santa Barbara-type of MNOI analysis, contrasted to what I would call a classic MNOI analysis. So the columns E and F are simply the books of record, just as I recorded them without adjustment in those columns. Those are the books. That's exactly the amount to the penny.

Q. Let me make sure I understand. You've said that you have labeled this as MNOI analysis, and more accurately stated it would be the MNOI analysis as specifically prescribed by the Santa Barbara County Rent Control Ordinance. Is that an accurate summary?

A. Well, yes, it is. The first three pages are the same way that they would look when I would do any MNOI analysis. But page 4 says, "Rent increases," "Following method set out in the ordinance." So page 4 is where it goes slightly different from the classic MNOI.

Q. Okay.

A. And then according to Santa Barbara MNOI. But all the others, really, are identical, the technology I've used, the exceptions I've made, the line items that were pulled out or reduced or adjusted, all of those adjustments are the same types of adjustments that

Dr. Baar or I would make in these kinds of analyses.

Q. And in your professional opinion, those first three pages, the expenses that you included and didn't include or the items that you included or didn't include are appropriately treated pursuant to the county rent control ordinance, is that accurate?

A. Yes, that's right.

Q. So that helps us get an overview of the document. I take it your testimony would be the same regarding Exhibit -- or, I'm sorry, Table 3-B?

A. Yes. Table 3-B is really identical in form to table 3-A, but it has a different base year. Table 3-B uses a base year of 1994, Table 3-A uses base year 2007.

Q. I think that will help us as we go through this. The methodology is the same, just a different base year.

So then, go ahead. I interrupted you. You were starting to go through telling us about the income items.

A. Well, I was starting to say that columns E and F are the books of record and I'm not sure which tab they're at, but I believe in this binder there are the actual books of record, and anyone who has occasion to can check and they will find that the bottom line is identical. In other words, they track.

The books of record for earlier years were prepared by a different management company, and different management companies use different chart of accounts.

Q. Is that pretty typical in your experience?

A. Yes, completely typical. And indeed, some management companies change the chart of accounts over time, so when we do these kinds of analyses, as I'm sure Dr. Baar has encountered, it's cumbersome because you've got to kind of match two different bookkeeping systems and put them all on one piece of paper and make them correlate, and it's not always completely easy.

For example, looking on page 1, you'll see that many of the line items are preceded by a number -- 4100, 4310, 4300, et cetera. Those numbers are used by Waterhouse Management in its books of account, and that's one system.

The prior operator didn't use that numbering system. The prior operator used some -- named things, sometimes, differently, and amalgamated things, sometimes, differently. For example, going down the page, we see that the line item 5200 is wages for the managers, line item 5210 is wages for maintenance, and if you'll see column F has numbers it because that's 2010, but column E has, has no numbers in it. The reason is that, if you look down below, line 38, wages, $113,000. So in other words the prior operator's accounting system had wages of all types lumped in and, as we'll see later, it covered not only on-site management but maintenance and some other kinds of management.

So it's hard to have the line items line up perfectly. The point I'm trying to make is that the different accounting systems makes it a little hard to have a line item match perfectly and when anyone goes back to the books of record, it takes a little looking around to find the line items because the categories that these line items appear in are not always the same under all accounting systems.

I did it this way so that, as close as possible, employee costs are all here for both the earlier and the current owner.

Q. Let me ask two summary questions on what you just said. Would it be accurate to say that, not withstanding the differences in the books of record, based on these tables, 3-A and 3-B, if we go and look at what you put down for books and records for the two years -- excuse me, books of record for the two years, that we could go back and find in the actual books for the two operators these specific numbers?

A. Absolutely. Every line item can match back, the easy way do did to take the bottom line, by the way, is to simply take the bottom line. The bottom line on page 3 for 2007, for example, is that the net operating income is $145,915.54. That number appears in the books of record as the bottom line. So it's just an easy way, a thumbnail, an easy way of matching between the spreadsheet that I prepared and the books of record where I got the numbers.

Q. Okay, fair enough. And my second question then is, notwithstanding the fact that categories may not always be the same name and they may not always track in terms of the same number, I take it that ultimately what you have included in your MNOI analysis numbers and what you have excluded from that analysis are also, in your professional opinion, the appropriate way to do it under that analysis?

A. That's true.

Q. Okay. Why don't you take us through -- and I don't know that we need to spend a lot of time on it, but give us some highlights.

Let me start with income. It looks fairly easy. I assume the vast, vast bulk of the income is the rental income, the top, essentially, the first figure there.

A. Yes.

Q. And that's, regardless of the operator, you've got a number for that?

A. Yes.

Q. And I note also you have excluded gas and electric income, correct?

A. Right. Let me just preview my answer to that by saying, because I don't think I've said it yet, columns H and I --

Q. Okay.

A. -- is what I call an MNOI analysis. That is all the same numbers from column E and F, I just copied them over there, but then I went through carefully and I deleted some of them and I amended some of them. Every deletion is covered by a footnote, every amendment is covered by a footnote, and I can explain each of them in whatever detail you like.

Q. Thank you, I appreciate that clarification. Again, in your professional opinion, the things that you amended or deleted were appropriately done under an MNOI analysis, the first three pages of this exhibit?

A. Yes.

Q. All right, that's helpful. And as I was saying, I note for the income, for electric income and gas income, you've excluded the income, correct?

A. I did.
Q. And going down the page under "Expenses," we can see you excluded those expenses as well, correct?
A. Yes. It's common in these sorts of analyses to exclude gas and electric income expenses completely.
Q. And so I think really those are the larger numbers under income. If we go down under "Expenses" -- I think we've talked about that on the first page.
Why don't we go to the next page. Basically you have exclude some expenses as well that you thought were appropriate to exclude on the second page, correct?
A. That's right.
Q. Let me ask you about two of the larger ones town here. We have legal-general and management fees. Tell us about those.
A. Well, the legal-general are fees, I believe -- I think we'll find that very number on Table 4. I know we haven't gotten to it yet.
Q. Maybe we've rounded that down.
A. Yeah. I think legal-general are mostly fees having to do with preparing this application and the decision was that it would be -- it should be amortized, and that's why we took it off.
Q. All right.
A. Let's see what the footnote says. The note

says: "Legal and consulting fees services are included in another section of the rent increase."

Yeah, that's right. That's the judgment that was made because a $51,000 legal expense is not the kind of expense that occurs every single year, so if it was to be left in the budget, it would make a big difference in the outcome.

If on the other hand you take it out here, delete it completely from the MNOI, it means that the rent increase from the MNOI is significantly lower than it would otherwise be. But if that amount is appropriately amortized and allowed over some number of years at some rate of interest, then that is an alternative way to account for these particular legal fees and, in my judgment, it's a way that is more fair.

Q. All right. And just for point of clarification, I think what Mr. Garcia talked about, that actual fees were under capital improvements, the $50,000 basically related to the capital?

A. Thank you. Thank you for the clarification. I didn't know which category it was in.

Q. But again, I think your point was essentially you didn't include it in the MNOI so it didn't wind up being a factor in increasing the rent to the homeowners on a permanent basis?

A. Thank you. It's not an element in the MNOI. It is included elsewhere, because this was an amount that truly was paid in connection with expenses and has to be accounted for one way or another. But what you've just told me reminds me which category it appears in in the amortization chart.

Q. All right. Then I see, if you go down to "Outside Services - Consulting" for 3, were those consulting services that related to the preparation of the rent calculations, rent increase calculations?

A. I believe so.

Q. And then tell us about item line 91 -- well, the prior item I was thinking of was 94. But 91 is entitled "Management Fees" of roughly $35,000 and there's a footnote there. Tell us about your treatment of that.

A. Well, when I looked at this, I wondered where are the management fees for 2007 because there is no line item for 2007 in the books of account that is called management fees. But then I noticed that the wages for 2007 are way higher than the wages for 2010, and that seemed unusual and indeed unreasonable. The wages for 2007 were $113,000 and change, and the wages for 2010, several years later, are about $80,000.

Then what I noticed was no line items for management fees. It seemed to me likely that the wages covered management fees. I might say --

Q. Did the numbers essentially track, did they tie together?

A. They did track. I mean, the footnote here says that wages in 2007 was $113,000, and wages and management together in 2010 is about $116,000. So that seems right to me and it makes sense.

You know, we don't have available the detailed books of record from 2007 as we do for 2010 so I wasn't able to see what the line items were. I wasn't able to see who this $113,000 was paid to. If I saw that, it would be useful, helpful because then we'd be able to be more specific, but my assumption is that that's what happened. Maybe there's someone else who can explain this better than I can.

Q. Let's me ask you this. I think the important thing is, based on your analysis, is that the numbers essentially add up, they track because they are consistent, as you've shown us here in your note, the management numbers add up?

A. That's what it seemed to me.

Q. All right. So let's go on to the next page. And I want to ask you a few things. Line 98 you have property taxes. I take it those are the property tax numbers that we have been talking about before the increase. You've got the lower number and then the increased number, correct?

A. Yes.

Q. For 2007 and 2010?

A. Yes. And just want to point out that the numbers are not exact. The number for 2010, for example, on the chart we're looking at is $66,485.84, but the number in Exhibit C -- oh, no, that's 2009. Beg your pardon. Those shouldn't match.

Anyway, I was just going to make the point that I made before, that the amount paid in any one year won't necessarily match the tax year in any one year, but that's not an issue right now.

Q. Okay.

A. These are amounts that were actually paid.

Q. These are amounts that were actually paid, and they're fairly close to this, to the number you have in Exhibit C?

A. They are. In an attempt to clarify, you may notice that line 98 and 99 are both labeled with the number 5900, And that's because I simply broke category 5900 into two pieces, the $66,485 for property tax per se, and the $15,766.98, which was a supplemental tax bill from a prior year.

Q. Okay. And you took that one out, the supplemental tax bill?

A. I took that one out.

Q. And your notice says it's treated in another section of the increase notice, and you mean what you brought up in detail a few minutes ago, the regulatory lag, essentially the catch-up?

A. Yes.

Q. And by taking it out you avoid any double accounting of that, correct?

A. Yes, and by taking it out we've lowered the permanent rent increase that we are suggesting it is appropriate for the residents to pay.

Q. Right, and I guess that's what I meant by double accounting. In other words, we haven't imposed that on the residents to make them pay both permanent and temporary?

A. Right.

Q. Okay, so there we have it. So essentially, it's fair to say that, then, that this analysis then includes the property taxes so it helps us determine, under the analysis you have performed here, to what degree the increased property taxes impacted the net operating income?

A. Yes.

Q. And would the same be the case for the lease payment, the increased lease payment?

A. Yes.

Q. Then let's go to page 4. No, I want to ask you about one other thing. Maybe it warrants a little bit more explanation.

With respect to the line item 104, "Accounting and Legal" from the old operator, you reduced from $84,000 to $10,000. Why was that?

A. Well, when we focused on this number, $84,000 in legal and accounting in 2007, I initially had no way of knowing what that was. But in discussions with yourself, it became clear that a portion of that, a large portion of that was legal fees having to do with what I know as the Taylor lawsuit, is $74,044.78 was in that category, and it appears to be true that in the next year, 2008, an amount greater than $74,000 was reimbursed to the park because, as I understand it, there was an award of legal fees as a part of the Taylor lawsuit.

Q. In other words, the park won, Miss Taylor lost and the park received about $112,000, correct?

A. Right.

Q. And maybe I'll ask you this way. The books of record for Nomad Village, Inc., the prior operator, for

2008, showed an income of about that amount, $112,000, I forget, $112,000 or $114,000?

A. In the subsequent year.

Q. In the subsequent year.

A. Exactly. So that amount was reimbursed.

And in these kind of calculations it is well established that any amounts that were reimbursed should not be charged to the residents.

Q. Okay.

A. So we shouldn't be charging the residents with $84,000 that was spent in that year because it got paid back.

Q. Got paid back the following year?

A. So it was taken out and the residual is this number, $10,245.69 for 2007 as legal fees or legal and accounting fees, and I think I have a note down here saying that the average legal and accounting for the 10 years between 1994 and 2003 was $9,619 which I did that only in order to see whether $10,000 a year for legal and accounting made sense, and the answer is yeah, it makes sense, that's about average.

Q. Right. You kind of did that as a check to see if the $10,000 figure you put down was borne out by the history?

A. Correct.

Q. Let's go to page 4, then. And this I think you've identified as this is ordinance specific, correct?

A. This is ordinance specific with one exception that I will explain in a moment.

Q. Let me ask you an overview. For the numbers so far that we've looked at, both the numbers so far and the ones we're going to look at, do you believe that, in your professional opinion, all numbers and calculations are correctly done?

A. I do. I've done this just as carefully as I know how.

Q. Would it be fair to say that you correctly applied these numbers to the Santa Barbara County ordinance and did not just do a cookie-cutter MNOI analysis?

A. That's true.

Q. So tell us a little bit about, then, page 4, how you did this based on your determination what was appropriate.

A. To the best of my knowledge, I followed the ordinance precisely. The ordinance sets out in words exactly how the arbitrator is to make his decision, and I wanted to track that, so that's what I did. So I'll run through it. Would you like me to do that?

Q. Yes.

A. So line 140, which is labeled No. 1, has the actual CPI amounts in 2000 and 2010.

The next line, 141, does the math to compute the fact that it was a 4.2 percent CPI increase between 2007 and 2010.

And then the next line, 142, shows that 75 percent of the CPI increased from base year to comparison year is 3.1 percent.

The next line, 143, just records the base years space rent income.

And line No. 144 does the math. It's 3.1 percent of the line above.

So the CPI-justified space increase would be $16,823.

And then line 145, tracking the ordinance method, divides it by two, and so that number is $8,411.51.

That is the amount, as noted in line 145, that the ordinance says should be granted as the fair return on investment. And then it goes on to say that the other half should be granted as the CPI-adjusted increase against cost increases.

So then we look at the cost increases. Line 149, has basic operating year costs, line 150 has comparison year operating costs, line 151 subtracts the one from the other, to define the excess -- I'm sorry, to find the increase in operating costs, which is $119,881 and change. Then line 152 shows the excess increase in operating costs over the amount in 2, above, which the arbitrator is to designate for cost increase.

So in other words, the presumption is that the cost increases may be $8,411, but actually the cost increases turned out to be $119,881, so you have to add in this $111,469.

The item 4, line 154, says "The justified rent increase is the sum of these parts," it's the sum of the -- half the CPI that goes to the fair return and half the CPI that goes to the expenses, and then the residual of the expenses.

Q. So that's the sum of essentially the two $8,411's and the $111,469?

A. Right, two $8,411's twice, plus $111,469, and that sum is $128,292.

And then here's the item that doesn't appear in the ordinance, and it seems to me it should be and we should use it here. The calculations we have been doing cover the period from 2007 to 2010. And what this analysis shows is that there is $128,000 more that is justified on an annual basis.

But there was a rent increase. The current operator hasn't seen an increase since he took over, but there was a rent increase from before then. There was a rent increase halfway through the year 2007 and there was another CPI increase halfway through 2008. There's been no CPI increases since then, but those two increases do impact all of this, and those two increases allowed the income from the park, rental income, to increase by $28,330 per year. So we'd really have to take that off or we would be double accounting, because part of this the park got already.

Q. I see. And so that benefits the homeowners?

A. Yes, completely benefits the homeowners and that reduces the net justified increase from $128,000 and change to approximately $100,000.

Q. And so when you have essentially testified, in your opinion, the ordinance doesn't specifically require that reduction to be made, but you've gone ahead and done that because you think that it's more fair for the tenants to do so?

A. Well, you could put it that way. When I got from the city attorney a year and a half ago a copy of the ordinance and a copy of the rules, and a copy of some forms and one of the forms was the form that does this, on this page.

And the form wasn't in electronic format so it wasn't convenient for me to use it that way, so I basically did it myself this way. But it occurred to me a couple days ago I better check and do it their way.

Well, I did it their way and of course the form doesn't have this line which I call "Increase Already Taken." There's no such line in the form. They probably, whoever made up that form, wasn't thinking about the possibility that some increase could have been taken in the meantime.

So if you follow the Santa Barbara County form precisely, without thinking about what you're doing, you actually come up with a higher rent increase. It's in my binder down there. I think it was actually $66. It doesn't really matter because I'm not claiming that we should use such a number, but I'm just explaining why I didn't use -- literally use the Santa Barbara County form. It would disfavor the residents if we were to have used it. But nevertheless, all the rest of this, except for that one spot, it tracks the City -- the County of Santa Barbara's method precisely.

Q. So you have gone out of your way, then, to do this in a way that's slightly favorable to the homeowners?

A. Yes.

Q. That gets us to a space rent increase per space per month of $53.55 justified under this methodology?

A. Yes.

Q. And you have done a similar -- below this a similar increase analysis, and would it be accurate to say that that analysis on the bottom part of the page is identical to the one you just told us about, with the only difference being that instead of taking 75 percent of CPI, you've taken 100 percent of CPI?

A. That's correct.

Q. All right. And for that you get a justified space rent increase of -- permanent increase of $57.09?

A. That's right.

Q. All right. And so let's talk about that a little bit. Tell us, why did you use the 100 percent CPI indexing for that group of calculations?

A. You know, in this particular case, because it's only a few years, and inflation has been moderate, it doesn't make that much difference, but over longer time periods it makes a big difference, the difference between 75 percent CPI and 100 percent CPI.

There is no logical justification in economics or finance for using anything other than 100 percent CPI. There are CPI calculations done in our economy for teachers' salaries, for government contracts, for union negotiations, and there is no other context in the entire American economy, other than rent control, where any number other than 100 percent of CPI is used.

This business about 75 percent CPI, or in other jurisdictions it could be 65 or even 40 percent, is a purely political adjustment that harms park owners and assists park residents. It's purely political has no intellectual foundation whatsoever, or I should say, no intellectual foundation that can be sustained.

I have done a lot of work in this area and I feel very strong about it. So even in the case where it only makes, what, $1.50 difference, I believe in articulating this, and as we'll see in a moment, in Table 3-B it makes a huge difference. It makes a lot of difference and it really should -- it really should not be -- it should not be left unspoken.

Santa Barbara County is not alone in articulating what we call partial indexes -- in other words, some other number than this the CPI -- but the fact that Santa Barbara County is not alone doesn't justify it. It's not justifiable in any jurisdiction. It's not ever justifiable, because less than 100 percent CPI is completely incompatible with a fair return. You cannot allow -- calculations will never allow fair return if they're done at anything less than 100 percent indexing. Do you understand the phrase "100 percent indexing"?

Q. I do.

A. Okay.

Q. In your opinion, if the ordinance were to be applied to require 75 percent indexing over a longer period of time, would that be compensatory?

A. I don't believe it would be. Now, I might say, by the way, that the partial indexing is very often used for annual adjustments, but not always used for fair return adjustments, and that's for a really good reason, and it was articulated in the, I think it was Fisher versus City of Berkeley case, which the judge was very clear, and he said it may make sense to use partial indexes for an annual adjustment which, after all, is only an estimate. There's no expense figures presented for an annual adjustment, it's just presumed and it's automatic.

But, he said, when you do fair return, then you use the 100 percent indexing, you use 100 percent CPI, you don't make that adjustment because there's no reason to. We have the actual numbers, we have the real numbers and there's no justification whatsoever for adjusting the real numbers by any percentage at all.

Q. Now, let's talk about base year 2. In this particular analysis that we have just looked at in Table 3-A, your base year was 2007.

A. Yes.

Q. And in your opinion, is that the most appropriate base year to use in doing this analysis?

A. Well, let's me talk about that a little bit. We had figures, actually, from 1994 forward with a couple gaps. I've forgotten which year. We didn't have the numbers, but most of the years from '94 forward we had the data, which is unusual. It's quite rare that we have all that data, but we did in this case. And I catalogued it, I put it on spreadsheets and I took a look.

I didn't do the MNOI calculations on all of it, but I scanned it just to see, is there anything particularly unusual here? And no, there wasn't anything particularly unusual in the year 2008, and then we've talked already about things that became unusual at that time.

So then I thought, okay, which base year do we use? Well, 1994 was the earliest year that we had a consistent, clean set of books. So my first thought was let's go to '94 and do an analysis based on that year as the base year.

We actually presented a 1994-to-2009 analysis, as I recall, and I think you mentioned earlier, we presented that in the meet and confer with the residents as a backup to our main Schedule C or Exhibit C analysis. And it worked out.

But Mr. Stanton in his brief, he asked why 1994? And it was a good question, so I thought some more and it occurred to me that another base year that really makes very good sense is 2007, because it's the last -- I mean, the reason we're here is because the park changed hands, because the park changing hands created this lease increase --

Q. You mean there was a change in the operator?

A. Yes, I beg your pardon, a change in the operator. The lease fee went up, and the property taxes went up. Those were the two big items that increased. There were others, but those were the major ones.

So it occurred to me, okay, why don't we go back to the last full year for which we do have records of the old operator, which happens to be 2007, and use that as a base year. And on balance, I think that probably is the better choice although I felt that it would be probative to present here both, because I think corroborate each other, at least when one uses 100 percent indexing.

Q. And let me ask you one other thing on that. Does the ordinance prescribe any particular base year that you have to use?

A. No. It doesn't. The ordinance is not very helpful in that regard. It doesn't tell you what base year to use at all.

Q. So the ordinance leaves open to a good expert by yourself to make a conclusion as to, analytically, what the best year is to use, is that correct?

A. I think. So there are other ordinances that specify. San Jose, for example, spells it out. I believe they say 1983. That's the base year. There's no changing it in San Jose. But we don't have that requirement here. They also, in San Jose, made certain that park owners would save the data from 1983, and there aren't many jurisdictions that did that and it would have been helpful if other jurisdictions had.

Q. All right. And then let me ask you, to follow up on that, I think we can go through Table 3-B, at least for my question right now, in a very summary fashion. Turning to 3-B, and you've really talked about all this to a large degree, that's where you used, instead of 2007, you used 1994 as the base year?

A. Yes. That's the difference.

Q. And then I won't spend much time going through this at all, certainly not the first three pages, but for the purposes of question right now, because I think it will helpful, is look at page 4 and again I'll ask you in a summary fashion, would page 4 of the '94 base year analysis in chart 3-B contain the same analysis -- that is the same process -- for computing these calculations as Table 4 in -- excuse me, page 4 in Table 3-A?

A. Yes.

Q. All right. Now, basically, let me ask you a few summary things about it. If we look at this and we go through the analysis, if you were to use '94 as the base year and use 75 percent indexing, that suggests that this analysis -- or this analysis does suggest a justified space rent increase of $44.30.

A. Yes.

Q. Correct? And we see that on line 157.

A. Yes.

Q. And then if you use 100 percent indexing, in contrast, then it shows a space rent increase per space rent per month justified as $57.04?

A. Yes.

Q. And that's essentially analytically identical to the results that you got for the 2007 base year?

A. It is. I mean, it's off by five cents, so it's kind of extraordinarily close. That it is only off by five cents is really a matter of some chance because the data do vary as to the base years, and so it could have been a little higher, could have been a little lower, but the fact that it's close gives me confidence that it's close to correct.

And the fact, by the way, that the 44 is lower than the 55 -- in other words, that using 1994 doesn't give -- result in as large a rent increase, well, that makes sense because at the top part of page 4 in this chart, we're using 75 percent indexing and as I said before, 75 percent indexing, and as I said before, 75 percent indexing doesn't matter that much over a year or two, but over a lot of years, and we're here talking about 17 years, it becomes major. There's a lot of inflation that occurs over 17 years, and if you only get 75 percent of it, not 100 percent of it, you're adjusting the numbers quite significantly.

Q. So if we're comparing apples-and-apples kind of number, then the 75 percent indexing, then if you use a 1994 base year, we're showing $44.30, versus 2007 as the base year, we're showing $55.53?

A. That's correct.

Q. Would that be a further indication of why, in your opinion, 2007 is the most appropriate year to use in performing this analysis?

A. You know, the year, to my mind, I have to say it's kind of a toss-up, but the issue between 75 percent indexing and 100 percent indexing is not a toss-up, to my mind. That's really important. And the fact that the two match each other is corroborating.

Q. And if we were to go at 75 percent CPI, then, indexing, then 2007 is the one that gives us the $55.53, correct?

A. That's true.

Q. And in your opinion, based on all the analysis that you have done, is that a more appropriate number?

A. I think the number should be around $55.

Q. Based on this NOI analysis type of analysis?

A. Right. We have three numbers, 55, 55, 57 -- I mean four numbers, 55, 55, 57 and 44, and I think 55 is the most appropriate.

Q. So then the numbers that we've talked about here, then, is talking about the permanent space increases?

A. Yes.

Q. Not the capital expense?

A. That's right.

Q. And we've talked about the capital expense increases.

Your Honor, I notice it's about noontime and I'm kind of at a transition point. I've almost completed Dr. St. John, but it might be a good time to break for lunch?

THE ARBITRATOR: How much time do you think you need?

MR. BALLANTINE: Well, I do need to talk with him for a few minutes. I'd be another 10 or 15 minutes.

THE ARBITRATOR: How long should we break for lunch for? Let's shut down to 1:15.

(The lunch recess was taken.)

THE ARBITRATOR: Mr. Ballantine, do you want to --

MR. STANTON: We have a couple of housekeeping items, your Honor. First, I think we had some stipulations to make about the annual adjustments that counsel and I have discussed and, secondly, we wanted to make an agreement with respect to order of testimony today.

MR. BALLANTINE: Right. Your Honor, that's about the -- I think that's to formalize the fact that, as to what we call the automatic rent increase pursuant to 75 percent of the CPI, that's a little tricky because it varied by space, but as an exemplar, in Exhibit B, we have, I guess, some numbers. We have some numbers of what those would be, and then an increase. The increased dollar amount is space specific, but the percentage numbers for the three years in question would be the same.

I think we have a twofold stipulation. One, that the residents do not at this point in time object to that automatic increase. The petition suggested that they did. They do not, and I think that's stipulated to, so that's off the table.

And secondly, the numbers that we have for the amounts of the CPI are not in dispute, either, that's stipulated to as well, is that those are the appropriate numbers to use for the purposes of the rent increase.

MR. STANTON: I agree with that. If I can restate it from my perspective, the residents do not challenge and waive any objections that may have been made or interpreted as objections in the petition to the annual adjustment for the three-year period, the cumulative three-year period from 2008 to 2011, which differs per space, but it's less than $10. And in connection therewith, we stipulate to the correctness of the CPI multiplier that was used, the base data points for the CPI that was used to make that calculation, meaning essentially we have no issue about that part of it.

THE ARBITRATOR: Thank you. With that stipulation entered into the record, is there anything else?

MR. BALLANTINE: I made the invitation to Mr. Stanton, in light of the fact that he has communicated to us earlier before that Dr. Baar is unavailable tomorrow, I told him I didn't mind taking him out of order any time this afternoon, including now, and deferring my completing Dr. St. John and cross-examination of Dr. St. John. I just left it up to him.

My comment was I was fine with him doing that if the Court is okay with that and, of course, my only issue would be that it doesn't matter when we take him, I just want to be sure I have a chance to cross-examine him, which is why I thought starting sooner rather than later was better. So I'm not sure exactly where they are at on that, but I made that offer.

MR. STANTON: We will accept that offer, your Honor. At the conclusion of the direct testimony of Dr. St. John, if Dr. Baar can take the stand for direct and cross, and then if I can return to cross-examination Dr. St. John after Dr. Baar's finished.

THE ARBITRATOR: Thank you for that. Here's how I handle witnesses out of order. Towards the end of the day, particularly if they can't come back, I take the time remaining, cut it in half and make sure both parties have a chance to take a shot at the witness. Is that satisfactory?

MR. BALLANTINE: Yes.

MR. STANTON: That's fine.

THE ARBITRATOR: Thank you.

MR. BALLANTINE: So let's finish Dr. St. John first.

THE ARBITRATOR: Dr. St. John, please return to the stand.

Sir, you recognize you're still under oath?

THE WITNESS: Yes, I do.

THE ARBITRATOR: Mr. Ballantine, you may continue with your direct examination, sir.

MR. BALLANTINE: Thank you.

Q. Dr. St. John, we were looking at Exhibit D and I think we had just gone through Table 3-A and 3-B. One thing I want to ask you about, with respect to the numbers that you used for the adjustments, with respect to the applicant or the current operator here, Lazy Landing and Waterhouse Management Company, did their books of record show expenses for principal and interest?

A. Yes.

Q. And was that for principal and interest on the loan regarding the park?

A. Yes.

Q. Did you include or exclude those principal and interest expenses for preparing the MNOI analysis on Tables 3-A and -B?

A. They're excluded.

Q. Excluded?

A. Excluded.

Q. And can you show us where that is?

A. You know, in order to show you I have to take you over to the Table 5.

Q. Oh, okay.

A. And maybe we're going to get to it later or we can do it now.

Q. Let's do it now.

A. Table 5, page 4, down at the bottom, under "Other Expense," you'll see line 134, "Interest - Capmark," and in 2010, $198,496.

Q. Yes.

A. That number doesn't appear. These two sections, "Other Income" and "Other Expense," in Table 5, don't appear at all in Tables 3-A and 3-B.

Q. And is the reason why because none of those are appropriate to include in an MNOI analysis?

A. None of them are appropriate to include in an MNOI, exactly. These amounts down here are what I call below-the-line items which in many books of record are below the line, they are outside the net operating income.

Q. Okay, thank you for that clarification. Then with respect to the ground lease, you included those costs as operating costs in your MNOI analysis?

A. Yes.

Q. Because, in your professional judgment, it was appropriate and customary to do so?

A. Right.

Q. All right. You've analyzed and looked at the costs of the years in question in your MNOI analysis, correct?

A. I'm sorry, I don't understand the question.

Q. It wasn't very clearly framed. You've looked at the books and records for the years in question? Let me cut to the chase.

Have you looked at that and you've confirmed that the ground lease costs were included in the books of record for the relevant years in question?

A. Oh, yes.

Q. And you confirmed that they essentially approximately doubled?

A. That's true.

Q. Let's go to Table 5 -- 4, I'm sorry, Table 4. I don't know that we have to spend much time on this because I think we talked about this, but tell us what Table 4 is.

A. Table 4 simply does the calculations for the amortized components of the space rent increase.

Q. And --

A. Category 3, 4, 5 and 6. And it does the math, I might say. We were looking before at Exhibit C, and this is essentially the same as the bottom part of Exhibit C, but I put over to the right the amounts of space rent that would be implied by each of these amortizations, which I had not done on Schedule C -- Exhibit C.

Q. So essentially, it's the same numbers?

A. Same numbers, same numbers, just presented a little more clearly.

Q. Okay. And with respect to the $320,000 payment for the infrastructure, you've included that, correct?

A. Yes.

Q. And has that money been actually paid by the operator?

A. It's my understanding the money has been deposited into an escrow account. None of that money, as far as I know, has been actually used on capital projects yet, but it's designated for that purpose.

Q. And I guess my question is, your understanding is it's been paid into that account?

A. It has been paid into that account, to the best of my knowledge. I've seen a printout of the account which you referred to before, and as far as I can understand, that is an account statement showing that the money is there.

Q. So you base that number in part on what the park operator told you as well as on the account statement?

A. Yes.

Q. Now let's talk a little bit about Table 5. Why don't you tell us about Table 5.

A. Yes, Table 5 is responsive to the instruction that we are to give residents a five-year income-expense summary, or to give -- to make available to residents five years of books. This is actually -- I'm sorry, the ordinance says four years and we've done five years.

Q. Okay.

A. So this is simply the books of record translated into a single table and it does the math between the two operators so that column F and G, you may notice that they're in smaller print, and they're italicized and that's because they're each a half year, and then they're summed in column H as the full year. So those two, F and G, those two columns, half year each, roughly half year each, one from the books of record of Nomad Village and the other from the books of record of Lazy Landing.

Q. I see. So in 2008, in the darker print, where the non-italicized -- well, I'm sorry, it's in print, that's the aggregate of the two books?

A. That's right. That column H is the sum of columns F and G. So it puts them all on one page so one can see how it goes and how the five years stack up.

Q. And this is also essentially source information for the Table 3?

A. Yes, indeed, it is, this is source information for Table 3.

Q. Okay.

A. It also has the advantage, as I think I mentioned before, that if anyone was curious about a particular line item, they can look, in the case of 2007, they can look on the previous and the year right after and see if the number in question differs radically from surrounding years. And in the case of 2010, of course, one could look back to 2009 and see if that is close.

Q. Let me flip through some exhibits with you, and this should be pretty quick.

Exhibit G, then, does this at least include property tax information that you reviewed in performing your calculations?

A. Yes.

Q. And if you go three pages deep, there's something that looks like it's been downloaded from the assessor's website. Is that what you were speaking of earlier that you downloaded?

A. Right, these are the summaries. If anybody -- just to help anyone who might be looking at this, it is a little bit curious that on the assessor's website they call it the 2007 property tax, and then 2008 property tax and so forth. Well, I don't know why they put it that way, because what they really mean is 2007 to 2008 and 2008 to 2009, et cetera, which is what is shown on the tax bills themselves.

Q. All right.

A. That threw me for a little while. Then I noticed the numbers were all the same. So the website doesn't name it quite correctly, but the numbers are the same as for the fiscal year.

Q. So the first page here of this group, at least in 2007, would be 2007-2008, correct?

A. You know, in my book, there is no -- I'm sorry, yes.

Q. I'm three pages in?

A. Three pages in, yes. 2007 is really 2007-2008.

Q. Right. Because starting with the third page in, this group of documents are what you downloaded, correct?

A. Yes.

Q. Starting with the third page, this is what you downloaded?

A. That's what I downloaded before I had the actual tax bills in hand, so I was just curious at an earlier stage to see how this broke out.

Q. So then if we look at, first page of the group, 2007 and 2008, we see an assessed value of $1.9 million?

A. Yes.

Q. And we see a similar number slightly escalated the next year of 2008-2009 of $1.94 million?

A. Yes.

Q. If we jump to the next year, we see a net assessed value of $6.35 million?

A. Yes.

Q. And then we see a similar number for 2010?

A. Yes.

Q. All right. Then Exhibit H, this is the ground lease for Lazy Landing, and this talks about -- on page 1 it states that 20 percent of all collected rents from the property?

A. That's right. It says the payments shall be an initial payment of $500,000 and then 20 percent of the rent there forward.

Q. Okay. And actually that brings up a good point. Did you include any factor at all for $500,000 in performing any of your analysis?

A. I didn't.

Q. So to the degree or extent that they said that that was prepayment of rent, that was not included in any way as a basis for charging the homeowners?

A. It wasn't.

Q. Okay. Then thereafter it talks about an amount equal to 20 percent of all collected rent from the property?

A. Yes.

Q. Now, this also says that the 20 percent of the collected rent includes all capital improvements. Now, it would be fair to say, you didn't escalate the rent to account for capital improvements pass-throughs?

A. Well, there were none in effect in 2010.
Q. I guess I mean on a going-forward basis.
A. Well, I didn't project going forward, so it would be there. And it is interesting to note that the 20 percent, by contrast, is going through to any of these amounts.
Q. Okay. So that's an additional rent, though, that your calculations don't factor, at this point?
A. At this point.
Q. To the degree that there are capital improvements pass-throughs that increase the rent, then your calculations don't essentially anticipate that?
A. That is true.
Q. Like I said, I didn't want it take a lot of time on these, but let's go to Exhibit I.
This is the Nomad Village ground lease. I think it's on the second page but it's basically 10 percent.
A. You know, I've never seen that before today.
Q. Okay.
A. So as to my testimony, I don't think it would really help. The numbers I used were into a calculation based on 10 percent, I simply used the number in the book of accounts.
Q. That's fair enough. So your calculations were

based on actual rent amounts incurred?

A. Actual, not calculated.

Q. All right, thank you.

Then Exhibit J. I'll be brief. Exhibit J is simply a summary spreadsheet of capital expenses. But just I'll ask you, do the numbers tie into the exhibits you looked at? When we saw the $50,000 for professional fees on the -- on one of the three capital improvement items, that was from -- we can find that in this chart in kind of the middle -- $50,973?

A. That's my understanding.

Q. And the same thing with the $90,000 that we estimated, that was from -- the engineering and professional fees, that's the $89,211?

A. Exactly. I might just say, I didn't have this breakdown at the time that I put down those round numbers, $50,000, $90,000, $230,000, so I'm looking back at Exhibit -- well, Table 4 in Exhibit D, so -- and that would be the same numbers that were on Exhibit C.

Q. Okay.

A. And at the time that I prepared Exhibit C, or Table 4, I didn't have this breakdown, so the breakdown is a refinement and, as you just pointed out, the numbers are close.

Q. Yes.

A. And in the case of infrastructure improvements, if we use the number, the amount that's been put into escrow, it's also relatively close.

Q. Right.

A. The escrow account is, I think I remember, $327,000 and change, and here it's $320,000.

Q. Okay. And we'll talk about that more with other witnesses.

Let me have you flip down to Exhibit M. I'll go through these quickly. These are proposals. I'll note the first page is the one for the asphalt work. And my sole question to you as an expert is: Is work involving asphalt work regarding roads within parks something you typically see as an expense, capital improvement expense that's passed through to homeowners?

A. Yes. I think in the context of this ordinance, I think we call it a capital expense.

Q. All right. Rather than going through the rest of the proposals, not intending to spend a lot of time on this, let me just ask you a couple of generic questions regarding the cost of utility improvements.

The costs of making upgrades and replacement of utilities, is that something that in your work you typically see as a capital expense passed through to homeowners?

A. Broadly speaking yes, but if you're referring to gas and electric specifically --

Q. I am.

A. -- which are in a little bit of a different category than other utilities.

Q. Right.

A. What I understand, and I'm not an attorney and this is a matter that -- a matter that has been much discussed at law, and I'm -- I have no -- as an economist I have no particular opinion about these things, but as I understand it, there is some considerable debate about exactly how electric and gas income expenses and costs are to be treated.

It's very common in the work that I do with the maintenance of net operating income systems, that people kind of throw it all out. They just say we're not going to consider any of it.

But that, first of all, it's an imprecise throwing out, even in normal circumstances, because that throws out the common-area utilities, it throws out the costs the park incurs for street lighting, for heating the pool or the gas that heats the clubhouse. Those kind of things are then just not considered and the costs may go up, and they really should be considered.

So the problem is that when you have a

master-meter situation, the amount of kilowatt hours or therms for electric or gas that are used in a park for common area are not metered separately. So it is not easy to tell how much gas or electricity has been used by the park for common areas. It's a bit of a thorny problem and, like I say, a lot of people just throw their hands and up they throw it out altogether, which actually is what I did in the net operating income analysis.

Q. And we're talking about usage, correct, the income and expense from utility usage?

A. Yes, we are.

Q. All right. Let me ask you to focus more specifically on replacement and upgrading of facilities.

A. I was getting to that.

Q. Okay.

A. It is common in this context for maintenance of the utility systems to be set aside, also, for the cost of maintenance to be set aside. I used the phrase a moment ago "thrown out" -- in other words, not considered in a maintenance net operating income context. And there are reasons for that that have to do with, as I say, legal things that I'm not going to speak about.

But there's another category that goes beyond maintenance, which is replacement of systems. In my understanding and belief, replacements of a utility systems, like the replacement of wires, transformers, all of that, is different from the replace- -- or in the case of gas, the replacement -- for example, if you have to dig up the streets to replace the gas line, that's different from maintaining the system. The system requires maintenance and there is provision for those costs in the differential that Mr. Stanton mentioned previously, often called the discount, between the rate that the utility charges the park and the rates that the park is allowed to charge homeowners, and that differential is adequate for maintenance, but there's no way that that differential would be adequate for replacement of the entire system.

Q. The differential is not adequate for replacement of the entire system?

A. There's no way that it could possibly be. The differential on an annual basis, I don't have the numbers in front of me, I don't recall exactly, but it's in the area of $10,000 or something like that, which will cover, probably, maintenance, but it surely won't cover replacing whole systems.

Q. Okay.

A. So I think a distinction can be drawn here and

I think it's quite appropriate that in the materials that we're presenting we're suggesting that the electric system, for example, should be -- which may require very major replacement, should be considered as a capital improvement in spite of the fact that this differential exists to cover the maintenance.

And I might note that in Table 3-A and 3-B, I took out what might be considered maintenance items in 2010 for the utility systems, gas, electric.

Q. Would it be fair to say that Tables 3-A and 3-B, they don't account in any way for utility expenses for costs?

A. There's no utility expenses for costs in the analysis, that's true.

Q. All right. And let me ask you one other thing in regard to utilities. To the degree that parks incur expenses such as professional expenses, legal fees or engineering fees or things like that that relate to county -- or relate to regulatory agencies, is that something that typically is included as some sort of an operating expense by a park?

A. Can you repeat that?

Q. Sure.

A. I'm sorry, I was looking for numbers while you spoke. I'm sorry.

Q. That's okay. With respect to professional fees, such as legal fees and for professional consultants, is it related to dealings with regulatory agencies and the like, is that something that's typically an expense that's included in an expense calculation, either through MNOI or through another kind of amortized pass-through?

A. In my experience it is. I should say, I have known cases, ordinances that actually deny, but it's my understanding that the majority of cases do allow, and I think that there's case law on that, but you'd know better about that than I do.

Q. Well, fair enough. But let me ask you, as to this ordinance that we're dealing with in Santa Barbara County, do you see anything that told you to not include such costs?

A. No, no, there's nothing in this ordinance that I saw about that.

Q. Okay. And then, final questions for you, if you would look at Exhibits N and O, starting with N, I'm not going to ask you to go through the whole thing, but Exhibit N, does it appear to you that this looks like financial statements regarding the current operator of the park that you reviewed in preparation for your documents?

A. Yes. These are the source documents that I used in creating the charts.

Q. Okay. And this is for the current operator, Lazy Landing, correct?

A. Yes, that's true.

Q. And going to final Exhibit O, and again, without asking you to look at every page, does this look like the financial data sheets that you looked at and relied upon in doing your analyses regarding the prior operator, Nomad Village, Inc.?

A. That's right. These are those.

MR. BALLANTINE: Thank you, your Honor. Nothing further of Dr. St. John right now.

THE ARBITRATOR: Before we excuse Dr. St. John for now, I noticed the Nomad -- the previous operator's financials were unaudited. What about the existing financials?

THE WITNESS: It's my belief that they're all unaudited. I don't think any of these, and it's not common in my experience for these kinds of accountant summaries to be audited. There may be parts that do, but in my experience, they usually are not. There's no requirement, as far as I know, that they be audited.

THE ARBITRATOR: Thank you.

Sir, please step down, subject to recall.

With that, let's switch sides here and call your expert, Mr. Stanton.

MR. STANTON: Thank you, your Honor.

We call out of order Dr. Ken Baar.

THE ARBITRATOR: Mr. Ballantine, before Dr. St. John is excused, will those documents that he referred to be submitted into evidence?

MR. BALLANTINE: Yes. Thank you for the reminder.

And if it would help, unless Mr. Stanton has any issues, I would move our exhibits into evidence at this point. If there's objections we can take it up, but that gets it out of the way.

Mr. Stanton?

MR. STANTON: I have no objection to moving them in, subject to our ability to object, comment or explain to certain data that's contained therein. I wouldn't want to be admitting accuracy, in other words, of all the contents.

MR. BALLANTINE: Sure. I don't mean to include argument as to what it means. I think it's really foundational.

MR. STANTON: For that purpose, I don't have any objection.

THE ARBITRATOR: Let the record show that

Exhibits A through N are admitted into evidence.

(Exhibits A through N, inclusive, were received into evidence.)

MR. BALLANTINE: Thank you, your Honor.

THE ARBITRATOR: Mr. Stanton, are you ready to go?

MR. STANTON: Yes, your Honor.

THE ARBITRATOR: Doctor, please raise your right hand.

KENNETH K. BAAR,

Called as a witness on behalf of the

^ Petitioner ^ Respondent,

having been sworn, was examined

and testified as follows:

THE ARBITRATOR: Thank you, sir.

State and spell your name for the record, please.

THE WITNESS: My name is Kenneth K. Baar and the last name is spelled B-a-a-r.

THE ARBITRATOR: Mr. Stanton, please proceed.

DIRECT EXAMINATION

BY MR. STANTON:

Q. Dr. Baar, I'm going to first show you a document and just ask you if you can identify this for us. Can you identify that document, Dr. Baar?
A. Yes. It's a copy of my resume.
Q. And did you prepare this?
A. Yes, I did.
Q. Does this resume accurately represent your educational, teaching and writing background and history, if you will?
A. Yes, it does.
Q. So if you could just summarize quickly your education for us.
A. Okay, I have a law degree from Hastings College of Law, and I'm also a member of the Bar, and I have a Ph.D. degree in urban planning from UCLA, and I specialized mainly in housing and housing economics in the course of my studies and in writing my dissertation.
Q. All right. And I see you've done some teaching, correct?
A. Yes, twice I've been a visiting Fulbright professor in East Europe, in the early 1990s in Hungary, and in 2002 to 2003 in Albania, and for one year I was a visiting professor at Columbia University, in New York.
Q. And your resume also indicates at pages -- and I apologize because the pages are actually not

numerically in sequence, with page 5 being the number on the top page.

But on what is numbered pages 6, 7, 8 and 9, those appear to be articles that you have written or projects that you consulted on, is that correct?

A. Yes. Pages 6 and 7 are projects I have worked on, and pages 8 and 9 list my -- actually, 8, 9 and 10 list publications.

Q. During the course of your career, have you had occasion to do work in connection with mobile home rent control issues?

A. A substantial amount of my work in the last, I don't know, 15 or 20 years has been consulting to cities on mobile home park rent stabilization issues, and a substantial portion of that work has been preparing fair return reports on behalf of jurisdictions, rather than on behalf of residents or park owners, for the municipality or the county, which have been presented at various hearings similar to this type of hearing, administrative hearings on fair rate of return, and I've also worked with some jurisdictions on drafting ordinances and others I've done market-related studies about mobile home parks and mobile home ownership.

Q. Can you tell us approximately how many entities you've been hired by to consult for?

A. About 30 jurisdictions.
Q. Okay. And have you ever been hired by homeowners or residents?
A. Yes. I would say about -- this is a rough estimate -- I'd say about 15 percent of the cases I've worked on is where I have done fair return testimony.
Q. This case would be included in one that the homeowners have hired you as an expert?
A. Yes.
Q. Were you ever hired by a park?
A. Yes, in one case, yes, I was.
Q. Have any of your articles ever been published?
A. Well, pages 8 and 9 is a list of, you know, published articles.
Q. Those are all published, correct?
A. Yes, in journals, academic and professional journals.
Q. Now, on the very last three pages of this document, starting at the bottom of the page that's marked page 12, it indicates that there are some court opinions that apparently quoted you, is that correct?
A. Yes. Right. On page 12 is a list of court appellate and state supreme court opinions that, you know, cited my articles, discussions in my articles about fair return issues.

Q. And I misspoke, it's actually starting at the top of page 12, isn't it?

A. Right, yes.

Q. And then the jurisdictions that you spoke of where you consulted, those appear on pages 13 and 14, is that correct?

A. Yes, those are -- yes, those are cities where I've prepared fair return rate analyses of rent increase applications on behalf of cities.

Q. Okay. Now, were you asked to perform a task in this case by the homeowners?

A. Yes. I was asked to review the application, and I wasn't asked to retain in the matter of the court in this case, which often I am, or usually I am, I was retained to review the application.

Q. Have you reviewed the ordinance, the Santa Barbara County ordinance in connection with that project?

A. Yes. Well, I've reviewed the parts that deal with the rent, you know, rent increase standards.

Q. Now, when you are doing review work on behalf of a city, do you have a certain standard that you do that work by? In other words, what's your method of operation when you're doing review for a city as opposed to another party, anything different?

A. Well, let me say that the substance and the fair return standards substance I use are the same. It's different when I'm working as an expert on behalf of a city in the sense that I'll review the application, in many cities, to see if it's complete. I'll be able to submit questions in the course of reviewing the application to the applicant, but as far as the substantive -- I mean, I've written numerous articles and my reports are widely looked at and I consistently use, you know, analysis that is consistent, the substance of it. I'm not saying it hasn't changed one bit in 25 years, but basically it's the same substance and standards.

Q. Well, in this matter in which you're presently testifying would you say that your review has been done, in essence, the same as it would be done as if you were working for a jurisdiction?

A. Yes. Not in terms of the amount of time and not having a written report, but in terms -- let me say, the comments I'll make, if I were employed by a city, I would have the same analysis or conclusions.

MR. STANTON: We should probably mark, beginning marking these because I just have a few exhibits, your Honor.

THE ARBITRATOR: All right. We're going to use numbers for your side of the fence. So this will be Exhibit 1?

MR. BALLANTINE: Yes.

(Exhibit No. 1 was marked for identification.)

THE ARBITRATOR: The resume of Kenneth Baar. Any objections?

MR. BALLANTINE: No objection.

THE ARBITRATOR: Thank you.

BY MR. STANTON:

Q. In connection with the substantial work described in Exhibit 1, Dr. Baar, have you had a chance to work with or become familiar with different mobile home fair rate of return theories?

A. Yes, I have.

Q. Among those theories, is there a standard or formula or theory that's known as the maintenance of net operating income formula?

A. Yes, yes, there is.

Q. How would you describe your familiarity with that particular formula?

A. Modestly, I would say that I was one of the initial -- you know, initial leading proponent for the use of that type of theory in fair return analysis, and I think everyone understands, but maybe to clarify a little, basically this type of standard looks at the net operating income at a base date and presumes that's a fair net operating income, and the fair net operating income in the current year is that base year of that operating income adjusted by either 100 percent of the CPI or half the CPI. It's saying this is a fair starting point and the fair return today is an adjustment of that, and it's different than a return on investment standard which looks at the owner's investment, and basically I've taken the position that that's a circular type of standard, because the park owner determines the -- if you give him the best return on whatever they invest, they basically control the return by controlling the investment.

And the maintenance of net operating income standard has been widely accepted. Courts haven't said it's automatically constitutional, but in every case where it's been used, as far as I know, they have upheld it.

Q. So it's true that one of the benefits, I guess, then, that you would see to the MNOI standard is that it attempts to avoid the circularity problem that you just described?

A. Yes.

Q. Would you also describe it as a more objective fair rate of return determiner as opposed to the more subjective theories that you might be familiar with?

A. Yes. Because, I mean, in the maintenance and operating income standard, you know, there are still subjective issues about the reasonability of the expenses, what should be amortized, what should be allowed, but if you have a return on investment standard, for example, then you have the subjective issue of what's a fair rate of return, what's a reasonable investment, or whatever, and also what is a fair rate of measuring the investment? Do you take the original investment, do you take the original investment and adjust it by the CPI, or do you take the original investment and depreciate it? And courts have upheld all three methodologies and they lead to drastically different results, and there are huge differences in testimony when someone testifies what a fair rate of return is, so that type of standard is much more subjective.

Q. Now, you've heard Dr. St. John's testimony today, correct?

A. Yes.

Q. I think you heard his description of the MNOI and you're familiar with the fact that he actually used the MNOI formula in the calculations he's made, correct?

A. Yes.

Q. Do you agree in concept that using the MNOI formula would be a proper way to measure the fair rate of return to which the park owner is entitled to in this case, conceptually speaking?

A. Yeah, I think that's the most appropriate fair return methodology.

Q. Okay. Let's talk a little bit about some of the components of that. You mentioned this thing called the base year. What is that, in the MNOI formula?

A. Basically, that's the starting point, that's the net operating income from the base year that you presume yields a fair return. Some ordinances prescribe it as pre-rent regulation, some prescribe that the base year is the year of the prior adjustment.

Let's say the ordinance was adopted in 1990 but somebody got a fair return adjustment in 2000, then that would be the new base year.

In other ordinances -- you know, this ordinance doesn't specify for maintenance and net operating income standards, doesn't identify a base year in that way.

Q. Do you have an opinion as to how a base year should be selected if the ordinance does not prescribe a particular date, as this one does not?

A. Right, I feel if it doesn't specify a particular date, the idea would be pre-rent, just before the rent regulation was adopted, and in the absence of data on that, I would say it's the earliest date that's it's available.

Q. Why is that?

A. Well, because you're looking at the impact, if you -- you know, of the fair return standard over time, and you're looking at the impact of the regulation over time, and so that's -- basically, I mean, I thought it was a little ironic today because to date, you know, 2007 was proposed but in other cases, Dr. St. John has testified that one should always use pre-rent regulation, and in other cases where the ordinance says you don't use pre-rent regulation. So I felt -- I didn't feel he was consistent with his prior testimony today about that. And I've been criticized in the past for not using pre-rent control, but I feel in this case there's no reason not to use the pre-rent control. It's available and the ordinance doesn't say you should use a later date.

Q. So in your opinion, of the base dates used in the calculations by Dr. St. John, it would be the 1994 base year data that would be more accurate than the 2007 base year data?

A. Well, I wouldn't say that. I think it's a more accurate and more conceptually reasonable because you're looking at the impact of the regulation over time.

THE ARBITRATOR: I would ask the witness to wait until the question has been asked before you answer.

THE WITNESS: Oh, I'm sorry.

BY MR. STANTON:

Q. So as long as we've got a base year potential subject where we have the information readily available, your testimony is it should be the earliest possible year, where that information is available, is that correct?

A. Yes. As far as back as the year before regulation, not going 10 years before the regulation.

Q. Now, ordinance in this case has an indexing for the annual adjustment that's allowed without a hearing of any kind, correct?

A. That's correct.

Q. And you recall what that is?

A. My understanding is 75 percent of CPI.

Q. All right. And is that, in your experience, a typical, in terms of a range, a fairly typical indexing number for annual adjustments, for example?

A. It's common. They range from 50 percent to 100 percent CPI. It's an even distribution: About a third of the ordinances are 100 percent CPI, about a third are 60 or 70 or 80 percent --

Q. Do you recall how many mobile home ordinances exist in the state of California?

A. About 90.

Q. And is it your -- would you say that you're pretty familiar with most of those ordinances?

A. Well, put it this way, I'm aware of the patterns in the ordinances. Obviously, I can't memorize 90 ordinances, but I know what's common in them.

Q. Unlike this particular ordinance, many ordinances also actually script out an MNOI formula within the terms of the ordinance, correct?

A. That's correct. And many don't. A fair number do.

Q. I think Dr. St. John might have referred to that as the pure NOI sort of formula as compared to the Santa Barbara formula. You understood his testimony in that regard?

A. Right. Well, I think I do.

Q. Let's talk about the issue of indexing. Now, in addition to using a percentage of the consumer price index for annual increases, do ordinances that provide

MNOI formulas also provide a specific indexer, if you will, for a percentage of CPI for determining the difference between the base year and the current year and comparing those?

A. Okay, most of them do, some of them don't. And they range -- some of them prescribe a -- the low end that you index the base year by 40 percent of the CPI, the high end 100 percent of the CPI increase.

Q. I think you have a document in front of you that is entitled "Appendix A, Indexing Ratios in MNOI Standards." Do you have that document there?

A. Yes.

MR. STANTON: I provided counsel with two copies of that. I'll provide one to your Honor now.

THE ARBITRATOR: Did you wish to mark this?

MR. STANTON: Yes. It's Exhibit 2, I believe.

THE ARBITRATOR: Yes, sir.

(Exhibit No. 2 was marked
for identification.)

BY MR. STANTON:

Q. Dr. Baar, this document that we've marked as Exhibit 2, is this a document that you prepared?

A. Yes, it is.

Q. And what is this intended to show?

A. Well, basically, I mean, there's been a running debate for 30 years or whatever on whether 100 percent of indexing -- you have to index that upper income by 100 percent of the regular increase in the CPI, and the rationale for 100 percent indexing and the rationale for less, but basically the bottom line is that the courts have said that 100 percent indexing is not constitutionally required and, as I say, this debate has been going on for 30 years.

The first courts were upholding less than 100 percent, ordinances with less than 100 percent indexing. But then there were two recent decisions -- I say "recent," in 2005, 2007, and they're mentioned on page 4, or starting on page 3 of the exhibit, and going to page 7 -- which specifically rejected the argument that 100 percent indexing was required and, you know, that's -- so that's the fair return law.

Q. So is it true that it would not be unique to find the jurisdiction that would index at 75 percent of CPI when implementing the MNOI formula?

A. No. Well, page 1 certainly indicates that.

Q. And do you personally find any problem with using 75 percent of CPI when you employ an MNOI formula?

A. Well --

Q. As opposed to using 100 percent?

A. Well, basically what happens is -- it's a little complicated. Typically, not in all cases, but usually in a mobile home park investment is a leveraged investment, so what that means is that even if your income grows at less than the CPI and operating income, your equity can grow at a faster rate and the simple way to explain that is with the analogy of a house purchase. You buy a house for $100,000 and let's say you borrow $80,000, you've put in $20,000 cash, if the home is only going up by 20 percent, let's say, from $100,000 to $120,000, well, the home value is only going up by this amount but, on the other hand, your equity has doubled because you borrowed 80 percent of the purchase price, so basically -- and the other way to look at this is that this a return on a fixed investment, it's not that the investment is growing every year. I mean, if you bought a bond you get the same amount of money every year, the return doesn't grow at all and, arguably, in real estate literature they say, well, real estate is more risky but a mobile home park is certainly not a risky investment. You've got these captive tenants that can't move their homes, these mobile home homes are on the land, so I've never seen a rent risk in a mobile home park. There's a rent risk in start-up, but once the park is full, there's no more rent risk and, plus, in the last five years we have wondered about if any type of investment is safe, bonds or banks. So there's rationale for 100 percent indexing and there's rationale for less than 100 percent indexing.

But I also want to say, to put this in perspective. Dr. St. John said it doesn't really matter, or it's a very small difference for the last three years, but he felt this was an important principle. But even if you go back to his '94 analysis, the difference is only $13, I think. Between the Table 3-B, page 4, the difference between the 75 percent of CPI index and 100 percent indexing is only about $13. So it's not a major issue in this case. I've seen it be a major issue where this indexing goes back to 1979 or something, and in this case I see it's not a big issue.

Q. Do you believe that the employment of the MNOI formula in this case should use the 75 percent indexer or the 100 percent indexer, and why would you pick one of the two?

A. Well, I would use the 75 percent because what happens is the annual adjustment is less than 100 percent of CPI, and if you have an annual increase of less than 100 percent -- less than 100 percent of CPI, it's unlikely that the NOI is going to grow by 100 percent of CPI. That's just an outcome. And the ordinance doesn't specify, and certainly 75 percent meets the institutional standard.

Q. So presuming that all of the actual content of what Dr. St. John has prepared and labeled as Table 3-B, which is the comparison between 1994 and 2010, and that's Table 3-B in Exhibit D, presuming that you agreed with all of the content, all the numerical content of the formula, and we'll get there in a minute, but making that presumption, would it then be your opinion that, in fact, Table 3-B should be used because it uses '94 as the base year and that the indexing should be 75 percent, which would mean that presuming all the numbers are correct, the calculation would be $44.30?

A. Well, I certainly think the 1994 should be used. As far as the indexing, the problem is the ordinance, as I say, doesn't specify your percent index, so I'd say 75 percent would be reasonable. There's no magic number.

Q. But the calculation that Dr. St. John has come up with as the numerical total, if you will, in Table 3-B on page 4, again, assuming that you agreed with all the content, you would say that $44.33 is the proper MNOI calculation summary number, if you will, as opposed to $57.04, which is at the higher indexing?

A. Right. I'd say it's the most reasonable in light of the fact that the annual increase is less than

100 percent of CPI. I don't want to say it's a black-and-white issue, but it sounds reasonable.

Q. Let's talk about some of the content of the MNOI formula and some of the specific items that are at issue in this case. I think you have a copy of Exhibit C, do you not, in front of you, which is Exhibit C to the rent increase notice?

A. Yes, I do.

Q. And I think we've been using this as Dr. St. John's summary sheet. It's entitled "Nomad Village Space Rent Increase (May 2011)." You have that sheet, correct?

A. Yes, I have the one that says 2008-2009. Is that the one you're talking about? At the top it says referring to the years 2008-2009. I also have a complete application.

Q. I just want to be sure you have the correct document in front of you. It refers to the permanent --

THE ARBITRATOR: What tab is it in?

MR. STANTON: It's in Tab C.

Q. I actually took my Tab C and --

A. Yes, yes, I have that document.

Q. All right. I think it says "C" at the bottom.

A. Okay.

Q. I think it was also Exhibit C to the rent increase notice, if I recall.

So you are referring to this, or if you will refer to this, this is where we have the different increases numbered 1 through 6. Do you see that?

A. Yes.

Q. And as we go down the page, I want to first ask you about the lease payment increase. Do you see that No. 2 there on that sheet where it shows the increased lease payment of $58,622, do you see that?

A. Yes.

Q. Now, you've heard Dr. St. John's testimony this morning about how that issue and how that number came to be placed in his analysis, correct?

A. Yes.

Q. And you're aware that it is based upon an increase in ground lease payments for the operator of the park?

A. That's correct.

Q. Then the previous rental agreement and the rental agreement signed in 2008?

A. That's my understanding.

Q. Is it your opinion that ground lease payment increases should be included by a park owner in an MNOI analysis or in a separate kind of analysis where it's sought to be passed through, dollar for dollar?

A. No.
Q. Why not?
A. This type of expense --
THE ARBITRATOR: I'm sorry, that's a compound question. Please rephrase the question.
MR. STANTON: Let me break it down.
Q. Do you believe that the lease payment increase that has been described in this case should be used in connection with the application and implementation of an MNOI analysis?
A. No, I don't.
Q. Do you believe that it should be used in connection with a dollar-for-dollar separate charge, if you will, for the amount of the payment increase?
A. No, I don't think it should be included in the fair return analysis.
Q. Why not?
A. Well, I understand that this type of expense is allowed for tax purposes and accounting, but basically what happens is here you have a split ownership of the park in the sense that one person or entity owns the underlying land and another entity has a lease and the right to use the land, and basically this is a payment from one owner of the land with one interest in the land to another party that has another

interest in the land, so it's basically an allocation of the profits from the mobile home park, and it's the operator's investment in the park.

The operator, instead of purchasing the park, leased the land, and the ordinance, you know, clearly, first of all, it states -- the section that -- okay, this is on -- if you go to section 11-A-5, "Increase in Maximum Rent Schedule," and then go down to section F-1 and look at the last part of that section, it says that the park owner cannot include principal and interest on loans, shall not be considered.

And basically that's a statement or requirement that the acquisition cost cannot be considered, because if you could consider the acquisition cost, basically a return-on-investment standard, and you'd have a type of circularity. Somebody could pay as much as they want because they can then get a percentage on as much as they pay.

And basically, if you allowed the lease payments as an expense, you'd be allowing the park owner more, a type of rent increase they couldn't even realize they had bought the park instead of -- if the operator had bought the park, they could have passed through the principal or interest, but now the operator is asking to pass through their land lease payments instead. So you have this result where if you lease the land you can charge a higher rent than if you buy it.

You know, it's an acquisition cost and it's not -- I disagree, I don't agree with that. It is allowable for tax purposes or accounting, but that's different than, you know, rent regulation or price regulation.

It's simply a payment from one owner to another, and if the lease were amended tomorrow to provide that the park owner -- the operator had to pay 30 percent of the rent to the park landowner instead of 20 percent, then a rent increase would be justified under that approach. And then if you could argue about whether 10, 20, 30 percent is fair, the answer would be, well, whatever the market would bear would be fair. If the park owner -- you know, he could pay 50 percent to the landowner, it would just be a circular type of approach.

Q. Well, really, focussing on that circularity, is it significant at all that the rental to be paid here is a percentage of the collected rents on the property as opposed to just being some fixed number?

A. Well, I'd say either way it should not be included in a fair return analysis, because it's an acquisition cost for an interest that the operator has, and the fact that it's a percentage just makes it even more circular, because it's like, for example, if the rent goes up, it would justify -- it would increase the land lease payments, which would in turn justify another rent increase. I'd say either way, even if it was a fixed amount, it's an acquisition cost, it's not an operating cost of the park.

Q. So the circularity is that by increasing the base rent you increase the percentage of the collected rents number that the rent payment is based on, which in turn would justify another increase in the following year if the park owner wanted to bring another application, another increase again, and the rent needed to cover?

A. Yes, that's correct. I'm also saying that even if it was a fixed amount, the parties could renegotiate that amount tomorrow.

Q. Now, does the county ordinance in question anywhere mention the issue of ground rent or ground lease payments?

A. No, it doesn't.

Q. So it doesn't say that you can include, correct?

A. No. In the fair return analysis that I have done, unless the ordinance specifically allows it as an expense, as far as I'm -- as far as I know, it wouldn't be allowed. I haven't seen this as an allowable expense in cases where, you know, it's not specifically mentioned, and I'll say that's subject to the qualification that I haven't seen every case that's ever happened.

And there are some ordinances that, as I say, that do specifically allow it. There are also some that specifically disallow it, but that's been more in recent years, because when I drafted ordinances, I wanted to make this totally unambiguous.

Q. I'm going to ask you to refer to another document that you have up here that I'd like to mark next as Exhibit 3, that I provided to counsel. It has the word "Gardena" at the top of it.

A. Right.

(Exhibit No. 3 was marked for identification.)

THE ARBITRATOR: Please identify it. And identify Exhibit 2, please, as well.

MR. STANTON: Exhibit 2 was entitled "Appendix A, Indexing Ratios in MNOI Standards." If we can have that marked.

And the document that we're about to discuss is entitled "Gardena," marked as Exhibit 3.

Q. Dr. Baar, are you familiar with this document we just marked as Exhibit 3?

A. Yes, I am.

Q. What is this?

A. Basically, these are cases or examples of ordinances which specifically provide the lease expenses are not allowable expense, and from each ordinance, the section that I -- I put the fair return section in this document, but then I put the provision that dealt with the lease of land expenses in bold. And, you know, I have an excerpt, the Gardena ordinance, the Santee ordinance, the Santa Clarita ordinance, and the Upland ordinance, and those specifically provide that the lease is not -- land lease costs are an allowable expense. Some of them qualify when it's allowed.

Q. So it's your testimony that this is the exact language from those ordinances now in effect that you have replicated here?

A. Well, it's in my collection of ordinances and they rarely change. So when you ask me is it now in effect, I haven't gone back to verify this if they're still in effect today, but I assume they are.

Q. I understand.

You heard Dr. St. John testify, I believe, to the effect that ground lease payment scenarios, ground lease relationships are fairly unique in mobile home park ownership, is that correct?

A. Well, they exist in a small minority. I wouldn't say -- I'd say a small minority of the cases.

Q. Do you have any way of putting a percentage on that for us?

A. No. I mean, I'm guessing. I've done, let's say, 60 fair return reports and I have seen it -- I don't think I've seen more than 5 of them, but that's just a guess.

Q. Okay. So do you have an opinion, then, as to how this lease payment increase should be treated?

A. I'm saying it's an investment expense, it should be treated the same way acquisition costs is treated in this ordinance, which is not allowed to be considered.

Q. So to make sure that I understand your testimony, are you saying that on what we've been referring to as Exhibit 3, item No. 2, "Lease Payment Increase," that that number should just be deleted out of there because it's not allowable?

A. It should not be included in the fair return analysis. I'm not questioning that it exists.

Q. Right. So you're saying that that would apply not only to Exhibit C, item 2, the way we see, as a separate line issue, but if you were going to use it in the MNOI formula you'd have the same conclusion, right?

A. Yes.

Q. And I mean, I stated that wrong, not that you said you would use it, but if someone were to propose to use it in the MNOI formula, you would find that objectionable for the same reasons?

A. Yes.

Q. All right. Now I want to draw your attention to item 3 on the summary that's entitled "Capital Improvement." Do you see that?

A. Yes.

Q. Now, there are a number of items that have been summarized in the documentation that was presented today showing capital items that totalled $90,000, and I wanted to ask you a few questions about those.

Do you believe that including capital items which were incurred or paid for in previous years, such as 2004, 2005 or 2006, are proper to include in this calculation?

A. Well, let me say it would be unusual, and here you have a case where there hasn't been any infrastructure work done, or there have been some bids they've received but nothing real specific that's happened.

Q. The ordinance -- I think, we can agree that the ordnance does allow the park owner to recover prospectively, right?

A. Yes.

Q. And then do the work within six months?

A. Right.

Q. You've seen that part of the ordinance, correct?

A. Correct.

Q. With respect to any amounts that are contained in the capital improvement request, that would relate to sub-metered gas or energy systems, do you believe that any of those expenses, whether actual or projected, should be included in this analysis?

A. Okay, the expenses related to sub-metered systems, whether they're for replacing them, whether they're big, whether they're small, the courts have ruled that those are preempted by the utility regulations. The utility regulations provide that a park owner gets a differential between what they charge and what they pay the utility company, that there is a difference. They can charge the residents more than they pay the utility company, and that differential is designed to cover the costs of maintaining and replacing the system, or whatever, and the Rainbow -- Rainbow versus Escondido decision made that absolutely clear, and in that case the park owner had spent about $200,000 on gas and electricity expenses and I concluded that, based on the preemption, that those should not be allowed, and the Court upheld that.

And today Dr. St. John said, well, this is not possibly adequate if the park owner actually has to replace everything. Well, I guess my answer is it may be adequate, it may not be.

But then his argument is with the PUC, but the law has been very clear that this should not become part of a rent control fair-return ^ analysis because it's preempted by the State and it's not the job of localities to determine how much people can charge based on their gas and electricity expenses. Park owners, for sub-metered systems, that's regulated by the State.

Q. So you were actually involved in the trial court proceedings in the case of Rainbow Disposal Company, Inc., versus Escondido Mobile Home Rent Control Board, is that correct?

A. No, I was involved in the administrative proceeding.

Q. Oh, I'm sorry. I misspoke.

And I note that the decision quotes you rather extensively and that comes from the administrative portion of the lower proceedings, correct?

A. Yes, that's from the administrative hearing.

Q. The $200,000 for gas and electric improvements, do you have any specific memory of what that was, beyond what's stated in the case here?

A. No. It was over 10 years ago.

Q. Okay. And what you mentioned about PUC law, if I can paraphrase, is that what you gleaned from reading the PUC ruling that the Rainbow case appears to quote what is called the "Rates, Charges and Practices of Electric and Gas Utilities" case?

A. Yes, to the best of my memory, that's the name.

MR. STANTON: Your Honor, I've already provided a copy of the Rainbow decision to your Honor, and to counsel. I'd like to mark that as Exhibit 4, if we could, please.

THE ARBITRATOR: Okay, the case is court of appeals case Rainbow Disposal Company.

MR. STANTON: Yes. It's on the LexisNexis letterhead there. It's the actual decision of the appellate court.

THE ARBITRATOR: That will be Exhibit No. 4.

(Exhibit No. 4 was marked for identification.)

BY MR. STANTON:

Q. Now, do you have an opinion about whether or not any professional fees that are generated in connection with sub-metered gas or electric repairs or maintenance or infrastructure work can or cannot be properly charged as an expense item?

A. No. That's part of the gas and electricity cost, so that would be an allowable expense.

Q. Okay. I want to call your attention to item No. 4 on Exhibit C, which is entitled or labeled as "Uncompensated Increases." Now you've heard the testimony, have you not, of Dr. St. John in connection with these items?

A. Yes.

Q. And I believe he used a phrase, "regulatory lag," in connection with these items. Do you recall that?

A. Yes.

Q. And in your opinion, is it acceptable in a fair return application to provide a park owner with payments such as these that are described as regulatory lag between the time the park owner assumed operation and the time that they have not gotten around to making this application?

A. Well, if you go into the first part, I have indicated, if you go to line 29, "Increased Land Lease," I don't think it should be allowed into expenses.

Q. Correct.

A. And then if you go to line 28, where if I understand it, there's about three years of supplemental. It says "Supplemental Tax Increase," but it seems like this -- my understanding, this is -- this property tax increases is from starting around 2008. I don't know exactly when they were implemented, but generally, in fair-return applications, park owners don't make claims for past expenses unless they're just prior to the obligation and they couldn't possibly have claimed them sooner.

You know, I mean, if they buy the park, then they can't come in the next day for a rent increase. But what happens here is that, I just haven't seen this in other cases, going back a few years, you know, is they're saying that we didn't apply for that cost increase then, but we'll apply for it now, and that just hasn't been the pattern.

They could have had other types of increases, cost increases through the years, and basically -- I mean, there's no perfect system in regards to past expenses, but this seems, I don't know, in some ways extreme because basically what is going to happen is if these expenses are allowed, they are not going to be paid by the residents who are -- many of the residents are the same, but there are some residents who have replaced the residents who were there three years ago and they will be paying this cost increase that, you know, was incurred three years earlier and usually you can't -- there's no clear boundary between cumulative past increases, as opposed to regulatory lag where you couldn't have come in sooner to get the increase.

And this, to me, more looks like accumulating past increases. I mean, subject to that qualification. You know, I don't think it's reasonable but I'd say it's not a black-and-white issue, but it doesn't look reasonable to me.

Q. Using this theory, wouldn't it be possible to take every line item in the MNOI analysis and see where costs have increased and say the same thing?

A. Right, well, basically, yes, or claiming an increase in some other costs that occurred in 2009 or 2008.

Q. As well as, it's true, is it not, that the tenants now are -- if you charge them a $34-a-month chunk are having to pay for that entire amount, however long it's amortized, without ever knowing about it during the three years that it's accumulating?

A. That's correct.

Q. So they would be faced with the burden of having to pay now on 90 days' notice some amortized amount that they never knew even existed?

A. It wasn't a rent increase that they were asked for in the past and now they're being asked for an increase. And I'm not saying, you know, there's never a case where park owners can't pass through past expenses, but usually there's a balance of when the park owners would passing through past expenses, you know, if there's good rationale for why they weren't asked for before.

Q. I'd like to talk about item No. 5, and item No. 6, which are anticipated professional fees, two different categories.

Do you believe that these items, the $50,000 in anticipated fees for item 5, and the $125,000 in anticipated fees for item 6, are proper to be included in this analysis?

A. Well, I feel the ordinance provides for capital improvements that you can charge before you make the improvement, but the residents can have a hearing on it first. But I haven't seen, you know, where this kind of an expense where you can put -- you know, charge for the anticipated fee, you know, in making a claim about the property taxes, it should be adjusted because we don't know what the actual fee is going to be.

And this is interesting because it's a funny situation. This $50,000 spent -- one, it might be a very good claim and the residents might benefit from the property tax reduction because I assume it will be passed through.

On the other hand, it could be, you know, a frivolous claim. I'm not saying it is, and I haven't evaluated the claim, and that would be very difficult to evaluate. And then I thought, well, should it only be allowed if the claim is successful? That's one objective standard, because otherwise the residents are paying for an unsuccessful claim and, they could argue, well, it was reasonable to try. It's not a black-and-white issue, but I'd say the problem here is it hasn't even been incurred yet, the expense.

Q. Have you ever seen a case in which you've consulted or worked where anticipated professional fees were made a part of the application in any form?

A. Well, I've seen cases where application costs, most of them are known, and the last day the hearing -- and then there's a hearing at the end and some amount is anticipated, but I haven't seen, you know, where there's a large fee that's only anticipated. I haven't seen that.

Q. It sounds like you are focusing on item 6, which is labeled as the "Anticipated professional fees relating to the rent increase"?

A. Right. Well, I was just saying generally. Anticipated fees has usually been a small part of the total in the cases that I have seen.

Q. So it's your experience that an application such as this may properly charge residents for the professional fees generated in connection with this application process, correct?

A. For the rent increase application, yes. Yes, that's -- if you have a cost in getting a fair return, that's a reasonable cost.

Q. And typically, it would be done, structurally speaking, the way this exhibit shows, which is rather than make it an operating cost and put it in the NOI formula and roll it into the base rent that never goes away, it's a separate line item pass-through, if you will, correct?

A. Yes. And typically it's amortized because it's not the kind of expense that occurs frequently.

Q. Okay. So you're in agreement with what Dr. St. John was saying about how doing it this way is better for the tenants?

A. Yes. Well, it's an amortized expense so it should end.

Q. So you're in agreement with him on that?

A. Yes.

Q. So let's talk about the amount, if we can. I want to focus on the line item 6, the anticipated professional fees relating to the rent increase shown to be $125,000. Do you have any reaction to seeing that amount there?

A. Yes. That's a huge sum. Usually the cases where I have seen fee claims is a case where a park owner makes an application, the City goes over it very carefully, even to determine whether it's complete, there's a lot of correspondence back and forth, they look through the expenses with a microscope -- not always, but they look very carefully, and there's a lot of issues about documentation, sometimes there are issues about if the base rent is fair. Generally, you know, a lot of work goes in and typically -- you know, I'm not counting cases where there's a writ filed, but typically in those cases, the fees are in the $20,000, $30,000, $40,000 range, and here's a case where I see that, to me, the rent increase application process was fairly simple; the County, as far as I know, didn't do much review, basically. You know, it's -- the hearing was before an independent party, it wasn't before a rent commission where -- and there was not a lot of back and forth, and so I see less work and a much, much higher fee.

Q. In other words, we're in that process as we speak, correct?

A. Yes. So in my opinion this fee is completely out of line for this type of case.

Q. Let me ask you, do you typically see a breakdown of these fees in cases where there has been allowance of these professional fees?

A. Yes. Typically the park owner has to produce their legal bills. They can redact out certain things that are confidential, but they have to produce their legal bills.

Q. I'm going to ask you to refer to another document that I believe you have in front of you that is a two-page document in chart format that's entitled "Legal Expenses." I have provided counsel with a copy. I believe it is Exhibit 5.

THE ARBITRATOR: Identified as "Legal Expenses"?

MR. STANTON: Yes.

(Exhibit No. 5 was marked for identification.)

BY MR. STANTON:

Q. Dr. Baar, can you tell us, did you prepare this document?

A. Yes, I did.

Q. And what did you base the preparation upon?

A. Basically, this was -- I didn't go through every report I've done, but I actually prepared most of this for another case, for the City of Carson, and the case is what claims for legal fees were some recent cases.

Q. I notice the top one, which appears to be Carson Gardens. Carson 2006 is the most expensive of the lot. Can you explain any reason why that was $172,000?

A. Well, this was an exceptional case. Two were writs of mandate filed, there were three administrative hearings, and so this went up to the courts, then went up to the Court of Appeal, back to the trial court, back to the board, back to the trial court, back to the Court of Appeal, back to the board twice.

Q. Is it, in your opinion, appropriate to forecast in any proceeding that this back and forth and additional administrative or legal burden will be incurred? I mean, are we to presume that this is going to happen in every case?

A. No, it's an exceptional case, and they didn't claim they actually incurred it.

Q. Okay. And the second item there under Valley Breeze, in Yucaipa, there were two administrative hearings in that case, right?

A. Yes, and this is a city that reviews the applications very, very -- puts in a lot of effort.

Q. So the category of legal costs, what costs is that, if you could just confirm for us. Whose cost is that that we're talking about?

A. Well, it's the park owner's cost in making the application, having lawyer advise them, you know, what the rules are, the regulations, and then put together the application and providing representation at the hearing.

Q. So just to be sure, that is a column that indicates what the park owner is reporting to the city or the County as their legal cost, correct?

A. Yes.

Q. And the $57,213 amount was generated because there were two separate hearings, correct?

A. Right. And plus, as I indicated, it was in Yucaipa which goes over the applications very carefully.

Q. I believe at the very bottom line item, Valley Breeze, Yucaipa, refers to the same park, correct, and this talks about the resubmission after a writ was granted?

A. Okay, yes, okay.

Q. So that's the same park which is --

A. It increased -- I'm sorry, I made a mistake here. First it was $57,000 and then went up to $69,000.

Q. The other four items, Grandview, Ponderosa and Villa Vista on page 2, and Yucaipa Village on page 2 is where there was just one administrative hearing, correct?

A. Yes.

Q. And the range on those was $24,000, low, to $48,000, high, correct?

A. Yes.

Q. So are you indicating, based upon your experience as represented somewhat by this Exhibit 5, that you believe $125,000 is excessive to provide the park owner prospectively in this case?

A. Well, let me -- prospectively or retrospective, that -- assuming that the end to this case is the administrative hearing, or the hearing, it would be way out of line with what the typical costs are, legal costs and application costs, also includes the expert cost that park owners incur when they make these kind of applications.

Q. Okay, let's talk about the amortization rate. You heard testimony from Dr. St. John that amortization rate was used for the temporary increase items and I think it was consistent, 7 percent interest rate over a nine-year period.

A. No, it was 9 percent interest rate over a seven-year period.

Q. Oh, I'm sorry, you're correct.

So you obviously recall that better than I, or at least better than I wrote it down.

Do you believe that this is an acceptable amortization to use for any of the temporary increase items, assuming that those items are correct for the moment, that any of them might have been correct? We've talked about some might not be, but assuming they are correct, do you believe that's a proper amortization to use?

A. No. Unfortunately, there's not systematic data on what, you know, periods are used. I know what some jurisdictions use, but they seem low.

You know, I have indicated that the electrical shouldn't be counted because it's preempted by state law, but an electrical system that's completely replaced, or virtually replaced shouldn't last only seven years. I'm not an electrical contractor, but that's just my experience, you know, in listening to experts in these cases.

And the road thing is, the amortization for roads varies. Here the bids was for $400,000, which is substantial, so I imagine that's a major re-doing of the roads in the park and you wouldn't -- I don't think that would only, in my experience, you know, with these cases, the amortization period for that kind of expense has been longer, but I'm saying I'm subject to that qualification; I'm not a road contractor or road expert, but those seem short.

As far as the interest rate, typically I've seen 7 percent instead of 9 percent. If somebody goes out and buys a park today, that's the capitalization rate they could expect. That's the rate of return you could get on a real estate investment, which is lower than in the past, but that's because all other types of investments often paid close to zero.

Also, interest rates are low, money is very cheap to borrow, so 7 percent. I'd also point out, whether 7 percent is used or whether 9 percent is used has very little difference on the outcome, very little. Use a 15-year amortization instead of seven years, I think the annual costs would be about half, so that does have some impact, if the amortization period is substantially increased.

Q. The annual cost that the residents would pay?

A. Yes, because they would pay for a longer period but it would be have halved, and it would drop off, of course, sooner if it were paid off over seven years.

Q. I'll have you look at two more documents that I believe you have. The first one is a -- well, it's entitled at the very top, in small print, "Chapter 540-2, Mobile Home Space Rent and Stabilization," and it's a four-page document.

THE ARBITRATOR: Do you wish to mark this as the next exhibit?

MR. STANTON: Yes, that would be Exhibit 6, your Honor.

(Exhibit No. 6 was marked
for identification.)

BY MR. STANTON:

Q. If I ask you, Dr. Baar, do you know what this document is or where it comes from?

A. This is from the Contra Costa County ordinance. Many ordinances don't have the capitalization schedule in them. If I had more time I could possibly have found some more, but that one shows, if you look over at the second page, it shows the land improvement, such as roads, 20 years. But then on the other hand, for paving it says reslurry, four years, and resurfacing, eight years. And so I guess the question is what the park owners are doing. Is it closer to a new paving or is it closer to a resurfacing? It's clearly not, from my understand, a reslurrying.

Q. Just to make sure I understand the significance of this document, you're saying that what we're looking at is actually contained within the ordinance language itself in Contra Costa County?

A. Yes.

Q. And is this a schedule that that county actually uses, then, for mobile home park capital improvement analysis?

A. Let me say it's in their ordinance. If they don't use it, they are not following their ordinance.

Q. And then finally I'd like to mark as Exhibit 7, and I provided the hearing officer with this document, a two-page document which has page numbers at the bottom, 27 and 28. There's no title at the top. It begins with the words ". . . shall divide the total cost of the improvement," and appears to be a couple of pages out of a manual or a book of some sort.

(Exhibit No. 7 was marked for identification.)

BY MR. STANTON:

Q. Can you describe what this document is.

A. Yes. These are from the City of Yucaipa. Yucaipa is interesting because they have, I think, 30 mobile home parks, so they have a lot of mobile home park rent stabilization fair return cases and capital improvement applications, and this is from their regulations.

And this provides, on the second page, the amortization period for paving is 15 years. So these are just examples. And as I say, I'm not a roads expert, but you know, seven years for what seems like, you know, a real overhaul of the road system is a short period.

Q. So to summarize your testimony on this point, what you believe the proper interest rate should be that should be used for any of the temporary increase categories, does that appear on Exhibit C?

A. I'd say there's no single proper interest rate. I'd say the most reasonable would be 7 percent because that's the return if somebody goes out and buys a mobile home park today, that's what they expect.

Q. And as to time, do you have an opinion, based upon what we've just looked at, as to how long it should be amortized or would that opinion have to be based upon knowing what the improvements are?

A. Well, I guess what I would like to see in this case was, you know, some evidence from the park owner, the applicant, some opinion about what the useful life of this is or also maybe an opinion with the persons that made the bid about what the useful life was, so I don't want to say X number of years is the right number of years.

Q. Well, when we see item No. 3, capital improvements, third line item, "Infrastructure, $320,000," can you tell from this document what infrastructure we're talking about?

A. No. My understanding is that this is what the lender required the park owner to place into escrow. It's not connected to a particular capital improvement, as far as I know.

Q. I guess what I'm asking is, wouldn't you need to know what improvement it's connected to in order to really assess the time period over which amortization should be measured?

A. Right. Well, let me say this. The fact that the lender made the park owner put $320,000 in escrow for future capital improvements is not the basis for rent increase; the basis for the rent increase is a specific capital improvement that's identified, a reasonable estimate as to the life before it goes forward, and that's just not here, so I'm sort of testifying a little bit in the dark. I just know there's some money here that the lender required.

The fact that the lender required the park owner to put the money in escrow is not a basis for passing through. It's really a reserve amount until it's spent or it's expenditures identified in some detail.

Q. Let me try to ask sort of a wrap-up question here and going back to the MNOI calculation that's been presented, do you have any other comments with respect to specifically the tables that have been marked as part of Exhibit D and labeled Tables 3-A and 3-B? Do you have any other comments?

A. You're going to Exhibit D now?

Q. Yes. The specific MNOI analysis that Dr. St. John has presented that is marked and tabbed as Exhibit D in the binder that we received today.

A. Well, the comment I'd make is if you look on exhibit, you know, Table 3-B, page 4, and you go to page -- line 156, it says "Net Justified Increase, $79,732," and then you go back to page 2, line 87, and you see that the lease payments increased from $39,338 to $113,340, which is about $74,000, and the net justified rent increase is $79,000, so basically, you know, if the claim weren't made for the lease payments, that would basically have eliminated the net justified rent increase of $74,000.

Q. So the resulting MNOI number would, obviously, be a lot less?

A. Right. The justification for this rent increase under the MNOI standard is driven by the lease payments.

Q. Do you have any other comments to Tables 3-A or 3-B as they were presented today by Dr. St. John?

A. Okay, the other one I have which I remember was about -- maybe the questions would bring out the answer. The subscriptions went from a few hundred dollars to about $12,000. You'd have to find the line that's on.

Q. I think that's line item 84 --

A. Yes.

Q. -- on page 2 of the tables.

A. Yes. That should be clarified, because I've seen in a number of cases where the dues to the WMA, the Western Mobile Homeowners Association, which is really an advocacy group for the park owners, and I'm not criticizing the park owners paying those dues, but they wouldn't be an allowable expense, operating expense that can be passed through to the residents.

Q. In other words, you're saying it's advocacy which benefits only the park owner as opposed to the residents and it's elective and not mandatory?

A. I wouldn't say that it's elective and not mandatory, is not the issue, because you can say that about a lot of things, but it's not an operating cost to the park, it's a cost basically for advocacy, you know, to eliminate rent regulations, and there might be other uses for the money, but basically it's not for operating the park. But that's a subject that we haven't heard -- the park owner might have a different explanation of what those costs are for.

Q. Sure. Would you just want know more about that?

A. Right.

MR. STANTON: I may not have any more questions, your Honor. Can we take our break now and determine that?

THE ARBITRATOR: Yes. Let's take a 15-minute break and we'll be back here at 25 after the hour.

(A brief recess was taken.)

THE ARBITRATOR: Do you have additional questions for your witness?

MR. STANTON: Only a couple, your Honor.

THE ARBITRATOR: Proceed.

BY MR. STANTON:

Q. Dr. Baar, did you want to clarify anything about the base year testimony that you gave?

A. Well, I wanted to make one point because otherwise I'll hear about in the next case. I have recommended that the base year be back to 1994 because it's the first year that expense data is available, and I understand that's when the ordinance was adopted, or just before, and I wouldn't have recommended that it be the base year in a prior rate-of-return decision in this case. I want to make that clear.

Q. If there had been a prior fair-return hearing, you would have used that as the base year?

A. No, I would have recommended that that be used as the base year.

Q. Is there any case where you've ever concluded from the work you've done that a substantial rent increase ended up being justified?

A. Yes. The cases I've worked on are wide ranging, and there's a number of cases where I've determined that $85 or a $100 increase is justified, and there are others where I've concluded no increase was justified, and many in the middle -- you know, other ranges.

Q. Is this one of those cases where a large rent increase is justified?

A. No. Basically -- well, first of all, the first part of the underlying analysis is, as I indicated, if you take out the lease payments, which I don't think are justified as the costs of a fair return application, the park owner would be entitled to a very minimal increase, and the problem with the temporary increases is that there's money in escrow but there really hadn't been anything that's been identified as a basis for a cost increase, and the claim for legal expenses for the application, I think, is completely out of line of what would be typical for a fair return application. So I do not have precise numbers, nor have I put numbers into this, but I feel like if any rent increase is justified, it would be very small.

MR. STANTON: Thank you.

No further questions.

THE ARBITRATOR: Mr. Ballantine, any cross-examination?

MR. STANTON: Yes, your Honor.

THE ARBITRATOR: Please proceed.

CROSS-EXAMINATION

BY MR. BALLANTINE:

Q. Is Mr. Baar or Dr. Baar?
A. Well, "Dr. Baar" sounds stuffy, but I do have a Ph.D.
Q. All right. Dr. Baar, let me pick up on some of your last questions -- or your last answers to the questions regarding the rent increase.
As an economist, have you performed an assessment of exactly what the justified rent increase would be in this case?
A. No. I haven't made a particular calculation. And when you say "as an economist," I have an Ph.D. in urban planning and extensive expertise in fair return law, but I don't have a Ph.D. in economics.
Q. You're not trained as an economist?
A. No.
Q. You're not an economist, then?
A. No, I'm not an economist, I'm an expert in housing economics and fair return.
Q. But your Ph.D. is in housing, not economics?
A. That's correct.
Q. So essentially your knowledge of the fair return is essentially on the legal side?
A. No, I'd say it's on the real estate side, too.
Q. It's on the real estate side. You have training in economics?

A. Well, in the course of my preparing my Ph.D. I did a lot of study of housing economics, and when I taught housing, a lot of it had to do with housing economics. I mean, that's the best --

Q. Do you have training specifically in economics to the degree of analysis -- specific analysis using economic theories and mathematics?

A. No. My background in economics has do with fair return, has to do with fair return in real estate economics.

Q. But in whatever sub-field it is, my question, sir, is do you have a background and training in economics in the sense of using numbers and formula and mathematics to derive results?

A. Well, yeah. I mean in real estate economics you do all of that.

Q. What is your training?

A. Well, okay, let me say this. When you say my training, you know, in the course of my work I spent 30 years doing fair-return analyses, and in the course of preparing my dissertation was a lot of -- there was a lot of the -- how, you know -- how economics related to the real estate, but I didn't go to economics school.

Q. Did you take any classes in economics?

A. Rarely.

Q. Okay. So have you performed an MNOI analysis for Nomad Village Mobile Home Park?

A. What I did was I prepared comments or analyses of specific parts of this application, but I didn't come to a bottom number.

Q. So you have not prepared an MNOI analysis for Nomad Village Mobile Home Park, correct?

A. No, I haven't done that, you're right. I commented on specific parts of the costs claimed in this application.

Q. We're going to talk about the comments you made, but I want to be sure that we're clear. As you're sitting here today, you have not come with an analysis that you have prepared that you would purport to be an MNOI analysis?

A. That's correct.

Q. And secondly, as I understand your testimony, you haven't come today with a number in which you would say that this is the number, an appropriate number for rent increase that's warranted under the law, correct?

A. Right.

Q. So you don't have a number that we have to work with that you would say this number is okay.

A. Right, but I would say -- no, you're right. My analysis has been more certain parts of your number -- numbers should be changed.

Q. Like I said, we'll get into those pieces, believe me. But I want to be sure that as you're sitting here now, you don't sit here and say under the facts as you've assessed them and under the law that you claim to be an expert in fair-return analysis, that there's a number that constitutes a fair return for this particular park?

A. That's correct.

Q. Well, let's talk about some of the sub-sections.

Now, you talked about fair-return analysis, and you talked a little bit about using a base year value, and you said one of the things is with the base year value, or the base year, is to presume that the park owner was getting a fair return in that base year, is that correct?

A. That's correct.

Q. And do you know that Nomad Village Mobile Home Park, Nomad Village, Inc., was getting a fair return in 1994?

A. Well, let me say this presumption and my understanding is that was about when the ordinance was adopted, so it would have been close to the rent that the park owner, you know, picked or selected. You know, either regulation had barely impacted it or had not impacted it, and, secondly, there was no evidence that it wasn't a fair base rent.

Q. All right. So you said two things I think I want to break down. Now, we're talking about the 1994 analysis, and as I understand it's your opinion that you have expressed that this arbitrator should use '94 as the base year?

A. Right.

Q. All right. Under MNOI analysis?

A. That's correct.

Q. And I think you have two reasons from that. The first reason is that 1994 is about the year that the rent control ordinance came in effect, and so you're presuming that the park owner was getting a fair return because there were market forces that were in play that would have led to the numbers that we would see in their financials.

A. Right.

Q. Got it. And the second one was you haven't seen any evidence that the park owner wasn't getting a fair return?

A. Right. And other factor is that it's the earliest year that's available, to my understanding.

Q. All right, that's the third thing.

Well, let's go back to the first factor. I guess what you are essentially saying is that the idea would be that you go as close as you can to the time that the rent control ordinance went into effect because you have a park owner that's allowed to make their rents whatever -- essentially, whatever the market rate is and their expenses should be reflective of market expenses?

A. Yes, as close to the market as is available.

Q. Okay. And if you go further away, if you go into the rent control, a period of a time in which rent control has taken place, then we don't necessarily know if that's the case, correct?

A. You say "that's the case." You mean --

Q. What you just said, that the income and expenses are market based, well, particularly the income, that the income is market based?

A. No, as you go through time the income is more based on ordinance. The older the ordinance is and the more you're into it, the rent is set by the ordinance rather than the park owner.

Q. And wouldn't it be fair to say in those types of cases, the further away you get from the start of the ordinance, the more suspect the more -- or let's just say, the less value is being market driven with that year for being a base year for income?

A. Right. I'd say it's preferable, but I'd also say if you have -- you know, if you had a fair-return application, or if you don't have better evidence, that it's reasonable to use it.

Q. All right. Now, have you looked at the Santa Barbara County Rent Control Ordinance?

A. Yes.

Q. When did you first become aware of it?

A. Well, I don't know when I first became aware of it.

Q. Let me ask you this. When did you first engage in any study or analysis of the rent control ordinance?

A. Recent. Well, I say recently.

Q. For the purposes of this case?

A. Yes. I mean, I might have looked at it before . . .

Q. You don't have any recollection of doing that?

A. No, not specifically.

Q. And what exactly did you do to review the ordinance?

A. Well, I basically focused on the increases in the maximum rent schedule section. And because that's what I basically -- I basically focused -- that's what I basically focused on.

Q. When you were studying the ordinance, did you note that in fact the ordinance was enacted in 1994 but was enacted in 1979?

A. No. No, I didn't.

Q. You didn't know that?

A. Okay.

Q. You didn't know, for example, 11A-3, Exemptions, talking about the chapter applying as of November 21, 1979?

A. Right. Okay. I see what you're saying.

Q. And you didn't note that -- all right. So you weren't aware that it's been around since 1979?

A. No.

Q. So you would have to concede, then, that 1994, in fact, is almost 20 years after the rent control ordinance was first enacted?

A. Yeah, 15 years, yes.

Q. All right, 15 years. And so based on your testimony, you would concede that there's some question as to whether or not the 1994 numbers were truly reflecting market conditions?

A. Right.

Q. So that lessens its value as a base year?

A. Yes, it's not as good. I still think it's the best base year.

Q. Sir, there's not a lot of difference between 1994 and 2007, is there?
A. Well, I think there's 13 years.
Q. Well, what about 2007 makes it less valuable?
A. Well, I think, you know, basically you're just looking at the impact over a three-year period, comparing two points that are only three years part as opposed to comparing -- if you go back to 1994, you're comparing two points that are 18 years apart, and you're looking at how the rent increases compared with what would be a fair return. You're looking at the income at two points 18 years apart and so you're looking at a long-term impact of the regulation.
Q. Well, you're also looking at a point -- neither one of those are close to the time in which the ordinance was first enacted, correct?
A. That's correct.
Q. So to that degree, neither one of them is going to be particularly valuable in telling us that this gives us idea for the base year of what market conditions were like, "market" meaning unregulated rents for mobile home spaces.
A. Well, right, but I think that, you know, there's a big difference between looking at an impact of the ordinance over 18 years and looking at it over three

years, and what happened is that three-year period, you have property tax increase, but on the other hand, before the sale for 15 years, you know, 13 years, property taxes were going up 2 percent a year, I imagine.

Q. You imagine. But you don't know because you didn't study any of the financials for this year, did you?

A. Right. So you're looking at long-term impact, and the other you're looking at very short-term impact. Even if it's true that they were well into the rent control period, you're looking -- I think, basically, in these cases, you know, they have tried to use the earliest period possible. That's the theory, unless there's been a prior application.

Q. Was there a prior application?

A. Not to my knowledge.

Q. And other than that, other than just you like a long span of time do you have any other reasons for favoring 1994?

A. No.

Q. Can you identify anything that's happened between 1994 and 2007 that would indicate -- other than the passage of time, that would indicated one year is preferable over the other?

A. No, that's the factor, the fact that one is measuring long-term impact and one is measuring short-term impact.

Q. But you can't identify anything that's happened over that period of time, can you, that would somehow impact the MNOI analysis or make one year more valuable than the other, is that correct?

A. No, not apart from that.

Q. Okay. Now let's talk about the indexing amount. You've also said that we -- you think that we should use the 75 percent of CPI indexing and not 100 percent indexing, but your position is that it's not black and white and there's no specific rule in the ordinance or provision in the ordinance that governs that, is that correct?

A. Right. Except I would say one thing. The ordinance -- there is a provision that the adjustment -- that half the allowable annual increase is used as the profit adjustment factor, the return on investment. If you go to section 11A-5, and if you go to section (i)(1), it says: "First grant one half of the automatic increase to management as adjusted reasonable return on investment." And that seems to indicate that they're saying, you know, adjusting the NOI by one half of the automatic increase.

Q. You're saying it suggested that but it doesn't specifically say that?

A. It doesn't use that language, but it's the type -- it's an adjustment -- it's a profit adjustment as opposed to an expense, because section I-2 is the expense adjustment. Then, you know, there are also additional expense adjustments. Section I-1 is the profit adjustment, and that's something less than CPI.

Q. So as I understand your testimony now, you're essentially saying that there's no explicit requirement that the indexing from the base year be something less than the CPI index, but you think that the provision that you just mentioned suggests that that may be the better approach?

A. Right.

Q. All right. Now, you've also provided, I think, a justification for why you think it's okay not to let park owners, in calculating their fair return, not to go at 100 percent of CPI, even though you have CPI going along and, as I understand it, your position is because real estate is leveraged and the equity is growing. So the equity is kind of compensating for that, the --

A. In the standard case, yes.

Q. Okay. Well, how about this case?

A. This case, I don't know. But the regulation deals with the standard case and you don't want a system where you tie the rent increases to the particular leveraging of the particular owner. I mean there's strong rationale for not doing that.

Q. Your strong rationale, as I understand it, is because that real estate is leveraged and real estate equity grows, correct?

A. Yes, that's one rationale. It can grow faster than the increase in the rents.

Q. Okay, I understood that. Is there anything else, is there any other basis by which you justify less than 100 percent indexing?

A. Well, one thing is, the courts have said -- one thing is you have a kind of thing that -- you know, when you're looking at fair return, even though it speaks in economic terms, the courts have also said it's a legal concept.

If the courts came out tomorrow and said 100 percent indexing is constitutionally required, I wouldn't be here testifying that less than 100 percent indexing is okay. But the courts have done the opposite. In the Court of Appeal opinions they have said less than 100 percent indexing is constitutional, you know, on the some of the grounds that I've described, and they have specifically upheld 40 and 50 percent indexing.

Q. Let's make sure we have apples and apples. In those cases we are talking about the automatic increases, correct?

A. No, talking with the NOI standard.

Q. The NOI standard for the indexing. But the rationale that you said and told us about, the reason why it's okay for the park owner, that you have said -- because you've said it's ambiguous in this case but it's suggested that, under the ordinance, that we ought to do 75 percent -- suggestion -- so I want to go into rationale as to where that came from, and your rationale is that the equity -- basically, the equity growth compensates the park owner for that?

A. In the industry.

Q. Do you have any other rationale?

A. Well, another rationale is it's, you know, it's not a growing investment, it's a return on a fixed, risk-free investment in land. It's a fixed investment.

Q. Anything else?

A. No. Those -- I'd say --

Q. Those are the two bases?

A. Yes.

Q. In this particular case the park operator doesn't own the property, my client doesn't own the property, does he?

A. No, he --

Q. He's not going -- he or it -- it's actually an entity, it -- it's not going to realize any equity gain, it's not going to have anything to sell when --

A. Right, but somebody else does own the property --

THE ARBITRATOR: It's question and answer, please.

MR. BALLANTINE: I'm sorry, your Honor.

Q. Go ahead, Doctor.

A. But there is somebody else. There's a split ownership in this property, in a sense. The park -- the applicant has a lease interest, somebody else owns the land, and they have a right to a return on that land. And there are dual owners of this property, and the return is growing and the value of the property is growing.

Q. But that's not accruing to the benefit of my client, is it?

A. Well, your client is entitled to a growth in net operating income, so I'd say yes.

Q. But your whole rationale for saying that the only growth he gets is 75 percent of CPI is the idea that the equity growth is going to compensate him, and I'm simply saying, that equity growth compensation is not going to happen for my client, correct?

A. No, it's going to happen for the land owner.

Q. Right, and that's not my client.

Now, your other issue was that return on a fixed investment, and you're saying a mobile home park is not a risky investment?

A. Yes.

Q. But essentially it has some risk, doesn't it? If my client is not able to get a rent increase and is operating at a loss, that is some risk, isn't it?

A. Well, let me say, nothing has no risk. I'd say that there's no -- you know, there could be hurricanes, floods, earthquakes, all that stuff. And I'll clarify. There's virtually -- I'm not saying it's 100 percent, but there's virtually no rent risk. Once a park is full, the mobile homes are there, if the rent goes up and it's really high, the value of the mobile homes goes down and acts a cushion. So basically, you know, the park owner has security that they can always get the rents for the spaces. They have the mobile homes as security on the spaces.

Q. Well, but they don't hold security interest in the mobile homes, correct?

A. Well, if the resident doesn't pay the rent they're going to lose the mobile home. And the park owner, my understanding, can make some kind of -- the mobile home is not, as practical matter, moveable so you have got this buffer in there, and the whole literature I've seen and reports over and over is that the vacancy rates, unless a park owner raises the rents through the moon, the vacancy rates are about 1 percent.

Q. But, sir, isn't there a further risk factor that if operating costs rise sufficiently, the park owner can't recover those, they're operating at a loss, that's a risk, isn't it?

A. Yes. It's not zero risk, they have a right under the ordinance to a growing net operating income, which means a right to cover their operating costs increases.

Q. We'll see about that, I guess, won't we.

Let me go, then, to some operating costs. The ground lease increase, you've challenged the recovery for any amount of increase in the ground lease?

A. That's right.

Q. And as I recall, your Exhibit 3 that you provided -- and this is from your collection -- and these are, as I understand, quickly glancing at these and your testimony, Exhibit 3 is various ordinances that specifically allow the land lease to be among the factors taken into consideration by the arbitrator or the rent control board for an increased rent?

A. That's correct.

Q. So bottom line is, Exhibit 3 tells us that these are ordinances that say if there's an increase in the ground lease for the leased land on which the mobile home park is there, that can be the basis for the operator, like my client, to come forward and ask for a rent increase?

A. Yes.

Q. All right. So I take it you would agree that there's nothing that -- there's no magic rule that says under no circumstances is a park operator allowed to recover increased costs of a ground lease because in fact some ordinances specifically say you can do that.

A. No. Right, no, I didn't say that.

Q. And you're not saying that these ordinances are unconstitutional, that there's something wrong with these provisions in these particular ordinances?

A. No. What I'm saying is where it's been allowed, it's been allowed subject to a specific provision, in my experience, that allows it.

Q. Can you identify a case where there wasn't a specific provision and it wasn't allowed?

A. Well, I can -- have to go back. In all the cases I've been in, and I'd have to go back through all of them, I can't remember where it was allowed when it wasn't specifically authorized. There haven't been a lot of these type of cases, but I have never seen it allowed where it wasn't specifically authorized.

Q. And my question is, can you point to a single case in which you have seen where you have an ordinance that didn't necessarily have a specific provision, at least was not one of these ordinances set forth in Exhibit 3, and which there was an increase in ground lease and it was allowed?

A. Okay, I can't point to a particular case. I'd have to go back through all 50 or 60 cases. I do have some recollections it's been denied.

Q. You have some recollection it's been denied but you can't tell me what case or where?

A. No.

Q. And, sir, Dr. Baar, you knew before you got here today that one of the bases for our rent increase was an increase in ground lease, correct?

A. That's correct.

Q. We didn't just spring this on you?

A. No, that's correct.

Q. But nevertheless, as you sit here today, you can't identify a single jurisdiction in which that was denied, a rent increase was denied based on an increased ground lease?

A. Right. And also, converse, I've never seen where it's granted.

Q. And you would certainly agree that there were ordinances that allowed for it?

A. Yes, I provided those.

Q. Now, your position is that, as I understand your testimony, that the rent control ordinance for Santa Barbara County -- you agree we're operating under Santa Barbara County's Rent Control ordinance in these proceedings?

A. Yes.

Q. And that it governs what we do?

A. Yes, I'm assuming that. Otherwise we wouldn't be here.

Q. Okay. And as I understand it your position, the Santa Barbara County ordinance, because it does not have an express provision allowing ground lease as an allowable expense that the arbitrator may take into consideration, the arbitrator cannot take the ground lease into consideration?

A. Yes, and I said there are other reasons, too. You know, it excludes investment expenses, principal and interest specifically, and, secondly, you know, allowing it would sort of undermine the whole sense of a maintenance and operating income theory which is basically that, you know, you're entitled to growth in the operating income, and what growth you allow doesn't depend on how much you invested or how you invested it, it's more the investor looks at what net operating income is allowed, and, of course, they can't predict inflation, but they're buying something with a right to growth in the net operating income, they're not under an ordinance where they can fix what the rent will be depending on how they fashioned the investment.

Q. Sir, I take it that argument is universal. That's a statewide argument, correct?

A. Well, it's an argument about maintenance of net operating income approach and fair return analysis.

Q. Well, that's not specific to this county, that's a general principle?

A. Yes, if I were in Sonoma County, I'd say the same thing, or anywhere.

Q. But notwithstanding you just made that argument, there are certain ordinances that do provide for that?

A. No, that's right.

Q. So those same arguments would apply in those jurisdictions, they would just have specifically chosen to delineate ground lease payments, among other things, as costs that they do allow as pass-throughs?

A. Yes, that's correct. It's not something I would recommend, but I would follow it if I were doing a fair-return analysis in those jurisdictions.

Q. In Santa Barbara County if we look at section 11A-5, sub-section f, sub-section 1 --

A. Just slow down a little. Section 11A-5 --

Q. Sub f --

A. Okay.

Q. -- sub-section 1. I want to go through that with you a little bit. First of all, sub-section F says the arbitrator shall consider all relevant factors to the extent evidence is introduced by either party, correct?

A. Correct.

Q. And it says: "Such relevant factors," and this is for determining an increase, permanent increase, "may include," and I think this is the key clause, "but are not limited to increase in management's ordinary and necessary maintenance and operating expenses," and then it goes on and lists certain things including increases in the property taxes and other things, correct?

A. That's correct.

Q. Now, you point out that ground lease costs are not included in that list?

A. Right. They're not operating expenses. I mean, they're expenses that your client has but they're not operating expenses.

Q. Okay. But you would agree with me, wouldn't you, that this ordinance specifically says that the relevant factors can include but are not limited to the enumerated clauses?

A. Right, I think this -- you know, this provides for, you know, this case for someone to consider factors that they consider relevant.

Q. Okay. And so one of those factors, you would say, that this arbitrator could consider if he considers it relevant would be an increased ground lease cost, correct?

A. Yes, if he -- yes, this is relevant. An arbitrator can include what that person concludes is relevant.

Q. And it's not prohibited from including a ground lease cost in these proceedings?

A. Right. I'm saying it wouldn't be reasonable. That's what I'm saying.

Q. But you're saying the arbitrator is not prevented from considering that cost?

A. Well, let me say this is a tricky question in the sense that on one hand it says relevant factors may include, but not limited to, so you can say because it says "but not limited to," you can include anything.

But on the other hand, I mean, obviously if they included the age of the park, included the age of the park residents, I'd say he's not allowed to do that. So it's not limited to a blank check. That's what I'm saying.

Q. That may be the case, sir, but what I'm trying to identify is, and I think you've agreed with me, that under the language of this ordinance, these arbitration proceedings and this arbitrator is entitled to consider, to the degree that he feels appropriate, increases in ground lease costs?

A. Actually, thinking this over now, it doesn't specifically say he's prohibited, but I'd say it would completely undermine the operation of the ordinance. So I would say in that sense it wouldn't be reasonable. Because the park owner, your client, can go out and sign a lease tomorrow where the park owner -- landowner gets 30 percent of the rent and that would justify another rent increase, or 40 percent.

So I'd say it would not -- I'll qualify it. When I said he's not prohibited, this language technically does not prohibit the arbitrator from considering that, but I'd say it's my opinion that it wouldn't be a reasonable and it couldn't be consistent with the purposes of the ordinance because you wouldn't have a rent regulation in the sense that there's no limit on what the lease can say.

Q. Well, but doesn't that come down to reasonableness, though? You're speculating on something that hasn't happened to come up with a fee that you deem to be an unreasonable fee?

A. Well, let me say this. In the absence of regulation, you know, let's say the rents could go up another $200 or $300, because mobile homes have become pretty worthless, but that would be the homeowners' problem, not the park owner's problem. So the park owner could say, "Well, I want, you know, 40 percent to 50 percent," and somebody could say, "Well, I'll pay this because I can raise the rent $200 and I can pass it through. I can pass through the lease, so I'll pay it. It's no skin off my teeth." It's no skin off your client's teeth if the lease payments double because it can be passed through.

Q. Not necessarily. That's a hypothesis, you're speculating. That's a hypothetical that's not before us.

A. Well, what I have seen -- when you say a hypothetical, you have these captive residents. So let's say, hypothetically, they pay $50,000 for a mobile home and the rent is $500, well, if the rent goes to $800, maybe the mobile home would be worth $5,000. And in places where there's not regulation, in some parks that's happened. There's a limit on that happening because some park owners are just not going to do that. They feel it's unconscionable, but that's what happens when the rents go way up. There's nothing the residents can do.

Q. They can petition in these proceedings, correct?

THE ARBITRATOR: Gentlemen, gentlemen, we're getting into argument, not question and answer. Let's get back to the Q's and A's.

BY MR. BALLANTINE:

Q. Sir, can you point to anything in this ordinance that says that this arbitrator cannot, is prohibited from considering what a fair return to my client is, cannot consider the increase in ground lease?

A. Okay. I think I've answered that. I said there's no specific language, but I would say it would be inconsistent with the ordinance.

Q. Do you have any evidence that you brought here today that shows that the 20 percent ground lease fee, rent, is -- was not the product of an arm's-length negotiation?

A. No, I don't.

Q. Have you brought any evidence to show that the ground lease fee of 20 percent is not a market ground lease fee?

A. No. What I was going to say, it's a return to the --

Q. Thank you. Let me ask you one other thing about ground lease. If you had a normal case for the ground lease in a base year and a comparison year and it was the same number, would you recommend taking the ground lease fees out for both years?

A. Yes.

Q. Can you think of a case in which that was done?

A. Well, let me say, any analysis that I've done, if the rent -- if the expense is not allowed in the current year, I've taken it out of the base year.

Q. But I'm asking you, can you think of a specific case where this was done, in the hypothetical I gave you?

A. No, I don't know of a specific case. I'm just telling you that's how I've done the analysis.

Q. Can you think of a case in which you recommended that ground lease fees be left out?
A. I know I've done that.
Q. Can you identify the case?
A. No.
Q. All right. Let's talk about the capital expense component of the rent increase.
You testified that -- I think your quote was basically to the effect that utility regulations preclude pass-through of any costs regarding the upgrades or replacement of the gas and electric system?
A. Yes, and I'll make one qualification that I didn't think of. The costs associated with the common area increases could be passed through.
Q. Well, okay.
A. That's usually a small percentage.
Q. Beyond that, though, I just want to go back to your testimony. Your position, I think, is that utility regulations preclude pass-through of gas and electric?
A. Right.
Q. Can you tell us what regulations those are?
A. Except for common areas.
Q. Can you tell us what regulations they are?
A. I don't know the section numbers. They're cited in Rainbow.

Q. As pointed out, the Rainbow decision was over 10 years ago, in 1998 it was finally published as an appellate opinion, so the underlying proceedings were before that time?

A. Right.

Q. So it's really for, like, a 15-year-old case, correct?

A. Right. I don't know how many, but it preceded 1998.

Q. And I guess the reason why I ask, isn't it true that since that time under Amby [phonetic] and other cases the regulations have changed dramatically?

A. Well, let me say, consistently in the city's rent regulation it's been the same practice and rule that the utility, gas and electricity expenses are excluded.

Q. Consistently in the what?

A. It's been a consistent rule in the interpretation in the jurisdictions, in those jurisdictions with mobile home rent control that the gas and electricity expenses are excluded, except for -- you know, I don't have to keep repeating it -- except in common areas.

Q. Can you cite a specific regulation that you claim is in effect right now, today, as we speak?

A. No. It's been a given in these cases.
Q. Were you aware that the Rainbow Disposal case was superseded by various proceedings in the CUP?
A. Not in regard to this factor, this conclusion.
Q. But you can't identify a rule or regulation that you contend is in effect right now?
A. No.
Q. Let's now go to under Exhibit 3 -- excuse me, Exhibit C.
A. This is in your exhibits?
Q. Yes. Exhibit C in the notebook, the exhibit book, that's the one-page spreadsheet, one page plus the notes on the second page. Do you have that?
A. Yes. You said Exhibit C and you said the second page?
Q. No, I'm sorry, Exhibit C, which is a two-page exhibit.
A. Oh, I'm sorry.
Q. I said it was a one-page exhibit and I corrected myself and said the second page has some notes on it. I apologize. I was talking about the first page.
A. I understand, yeah.
Q. You gave testimony about section 4, uncompensated increases. What we talked about is kind

of the regulatory lag.

Now, as I understand it, you've challenged the park owner's -- or the park operator's right to recover for any of that category, and setting aside the basis of the land lease issue -- I take it that the property tax increase, you don't dispute on theory that the operator is entitled to increased property taxes?

A. No, that's correct.

Q. So you've agreed with that. And setting aside your difference of opinion on the land lease issue, assuming but not making you -- solely arguing and not making you concede the land lease point, as I understand it you are challenging the right to collect this regulatory lag amount on the grounds that it's been essentially too long?

A. Right.

Q. Now, you said, I think, there's no boundary as to how long, but think it is too long in this case?

A. Yes. Unless there's a specific evidence that they couldn't -- they were changed, that they didn't even know it for years, but they knew when they purchased the park.

Q. When did they know about the property tax increase?

A. When you purchase the park -- okay, I take it back. They didn't because this was a lease and you're contesting that you didn't know when you bought your interest.

Q. Yeah. And we didn't purchase the park.

A. Right, you just got the land lease.

Q. Just the land lease, that's correct. So my question is, isn't it the case they didn't know right away, there was some period of time before they found out from the County that the County was taking the position that there was a property tax increase?

A. Okay. I'd say if, you know, if there was a justification for -- you know, I said if there was a justification for waiting for years, but I haven't seen one. Maybe there was; I haven't seen one.

Q. Do you know when the park first became aware that the County was taking the position that there was a reassessment --

A. No. I already gave testimony about that.

Q. So you haven't looked into that, you don't know what was going on during that period of time?

A. Right.

Q. So I think your testimony, then, may be that this might be a reasonable basis for --

A. I said there were exceptional circumstances.

Q. Okay. And so you don't have an opinion specifically on that point based upon any facts?

A. Right.

Q. Okay. But assuming that the park owner knew you were arguing that the park owner waited too long and they should have sprung it on the residents sooner?

A. Right.

Q. When?

A. When?

Q. Yeah, when? If they waited too long, I suppose you have an opinion as to when they should have done it.

A. Well, if they knew about it three years ago, I'd say, you know, within a year they should have, because it's a significant cost increase.

Q. But that's not a bright line, that's just --

A. Well, no absolute lines in this, but I'd say, you know, waiting several years to have a significant cost increase and then saying it's been a few years but now I want to pass it through . . .

Q. I take it part of what you're saying is it's better that the homeowners know sooner rather than later about a rent increase?

A. Right. We have a situation where old expenses were brought in. I'm not saying three years is real old, but basically, people should know what situation they're in, you know, and don't discover few years down the road that they have to pay for something that happened years ago.

Q. And under that rationale, wouldn't be better if homeowners knew in advance rather than after the fact?

A. Yes.

Q. And in contrast to 4 -- I understand your issues to 5 and 6. You argue it hasn't been incurred yet?

A. Right.

Q. So in that case, you criticize the fact that the homeowners know in advance, you don't agree with that in this particular case?

A. Well, the problem with these is, to me, they're estimates, they're not known. You know, we have an estimate of the property -- you know, one hand what I'm talking about, No. 4, property tax increase, but we haven't heard testimony about when the park owner knew it. That's the issue there.

And in 5 and 6, we're dealing with things, unless you know already that the professional fees are $125,000 for the rent increase, and there's an issue about that, and the property tax that, you know, we don't have much information about that, you know, about cost of the property tax increase. It says anticipated.

Q. So you would say that you want more information or that it shouldn't be passed through until after it's actually occurred?

A. I would say that both. Both. There should be more information and, secondly, they -- because what happens -- you know, the anticipated property tax fee is $50,000. What happens if it's only $10,000 that's spent?

Q. You're familiar with the --

A. This is a little different than the capital improvement that we have the bids. Of course, I guess you could project, as a lawyer, what it's going to cost.

And my issue with No. 6 is it's just completely out of line what I have seen in other cases.

Q. We'll get to that. Let's start with 5. Now, for that one, as I understand it, you don't necessarily dispute the concept of the fact that if the park incurs professional fees relating to a challenging -- assessing and challenging a property tax assessment, you don't necessarily disagree with the concept that that's something that the park owner ought to be able to recover the cost of --

A. Right.

Q. -- through a rent increase?

A. Right, right.

Q. All right. And you also, I think, acknowledged --

A. Let me say this. I said it wasn't a black-and-white issue because it's tricky. I mean, what if the park owner spends the $15,000 and gets nothing for it? I mean the lease owner, not the park owner spends $50,000 and gets nothing for it. Should the residents have to pay that? I said it's not a black-and-white issue.

Q. Why, in your opinion, would it be necessarily the success of that outcome be dependent on whether or not -- I mean, if the park owner really incurs the expense and that's actually what they incur out of pocket, why wouldn't the success of the appeal necessarily be derivative --

A. Well, the horrible situation is whether it's a good legal theory or not, the park owner can go out and spend the $50,000 and recoup the money from the residents, whether it's a wise legal challenge or not. That's part of the problem. I'm saying it's not black and white, and that's part of the problem.

When you have a system where somebody -- you have no incentive, and I mean your client, to not spend the $50,000 because whether it's a sensible expense or not, you get it, the residents pay it.

Q. Well, not necessarily. The residents have challenged it in this particular case, correct?

A. Right.

Q. In fact, you challenged it.

A. Right, but I'm saying if it wasn't challenged, if it was a right to pass that through, you know, you have this difficult situation. What if it's a nonsensical expense?

Q. Well, so here it is, it's in this rent increase notice. So as you sit here today, is it an appropriate expenditure or not?

A. No, I'm saying it's not a black-and-white issue. I'd say it looks like it's reasonable, but we have problems with it. I'm saying unfortunately, you have to say it's "yes" or "no" absolutely. In this kind of case, I haven't -- this is a case where we don't know whether it's reasonable or not.

Q. So you have no opinion?

A. Well, I think I've stated my opinion about what -- I feel it's reasonable, but I'd have concerns about it.

Q. Are you familiar with contested property tax litigation?

A. Let me say it's not something I've done.

Q. Are you familiar with the cost or what's involved?

A. No.

Q. Are you aware there's an administrative proceeding that would be followed by a writ of mandate proceeding in the Superior Court?

A. I would imagine that.

Q. And you understand there would be costs of attorneys' costs, accountants' costs, experts --

A. Right, right. The one variable here, the problem is we don't have measures of whether in these specific facts situations it's a wise challenge.

Q. All right. And is it your opinion that the ordinance gives the homeowners the right to make that determination, a legal assessment in advance?

A. Well, it would be hard to do. Yes, it would be very hard to do.

Q. Well, there's one thing we agree on. I'm just trying to find out what your opinion is.

A. I know that.

Q. And I take it you're familiar with experts -- excuse me, you're familiar with professionals working on retainer?

A. Yes.

Q. And a refundable retainer that they project what the cost is?

A. Right.

Q. And sometimes they refund it, sometimes they go over it --

A. Right.

Q. And --

THE ARBITRATOR: Gentlemen, one at a time.

BY MR. BALLANTINE:

Q. And, I take it, you wouldn't say it's necessarily unreasonable that a property tax appeal bill would be something that would be worked on on a retainer basis?

A. Well, let me say this. I'll accept what you say. I'm not saying -- I imagine it is. I'm not an expert on this.

Q. All right. And I take it, though, you noted in your review of the ordinance that in the event that the park bills the homeowners for an expense that they believe they are going to incur and then they no longer incur that, that they're supposed to refund the rent or, at least, cease charging for the rent once they no longer have the expense?

A. Yes.

Q. And as far as you understood, that would apply to this item, correct?

A. I think I'd have to go back, but I'll accept your word.

Q. In other words, if the property owner or the park owner collected for this in anticipation of spending a certain amount of money and then wound up not spending all of it, that they would provide that to the homeowners?

A. My understanding, also, is, though, that the advance expense allowances are connected with capital improvements, and I might be wrong about that, but I think they're connected with capital improvements.

Q. Well, do you see anything wrong about treating it in a manner like this under -- as a professional expense?

A. Well, usually ordinances, in a fair return proceeding, advance expenses -- I've seen them allowed where, you know, let's say in this ordinance, for capital improvements -- it's very specific -- or if it's a property tax increase that's certain to occur, but other types of expenses usually haven't been allowed. I'd have to --

Q. Let me ask you this relative to your last statement. What if the park owner had gone through and challenged the property tax assessment and whatever the outcome was and then came back and used that as the basis and said, "Here's the bill, this is what it cost, it was actually about $50,000, here's the bill for that," wouldn't you be sitting here saying, "You should have told us in advance rather than waiting for the two years until the litigation concluded"?

A. No. It would have been reasonable to wait until the expense was known.

Q. And you would acknowledge that this ordinance doesn't have a provision to petition an arbitrator or other board in advance of an expense to find out if they are granted the right to incur that and charge that expense to the homeowners?

A. Yeah, I don't think it has that type of provision. The capital improvements it does.

Q. Well, I disagree with you, sir. Can you show us where. Let me ask you this.

A. Oh, hold on, I take it back. The capital improvement has to be reviewed. You can go through a prospective capital improvement and say I'm going to spend $300,000 to redo the roads and I want this approved.

Q. Where is that?

A. Well, you go to 11A-6-(a)(5), and it says: "If the management fails to begin construction of the capital improvement within six months after the approval of the cost. . . ." To me, that says you can get approval before you've done it.

Q. I don't disagree with you there. I completely agree with that. I guess my question is this: You're familiar with ordinances. In some case ordinances basically say to a park, if you want to propose a rent increase, what you have to do is go to the rent control board in advance and propose it and the rent control will have a hearing and make a ruling on it. So the park owner has to ask before they can --

A. -- impose a rent increase.

Q. Yes. This ordinance doesn't have such a provision, does it?

A. Okay, I haven't focused on that. I think this was a case where the residents have to petition an opposition.

Q. You know, I'll represent to you the way this ordinance works is that the only way a rent increase gets reviewed is if the residents are noticed and then it's whether or not the residents choose to petition to an arbitrator, and so the only way a park owner can find out whether or not they're going to be allowed to have a rent increase on a certain basis would be whether or not -- what the arbitrator says. You don't disagree with that?

A. No, I don't disagree.

Q. And then -- fair enough.

And then I guess the other thing I want to look at relative to my prior comment is section 11A-9, cost savings, and I'll read it: "If management reduces or eliminates any service to a homeowner in effect on the date the ordinance codified in this section became effective, management shall reduce each homeowner's rent by his proportionate share of the cost savings due to the reduction or elimination."

Do you see any reason why that wouldn't apply to an advanced expense charged through that the park doesn't ultimately wind up incurring, such as a service, a professional service?

A. Okay, I think this is a good case that would apply to what you're talking about.

Q. Thank you.

MR. STANTON: Just for the purposes of clarification, that last question, that's referring to section 11A-10 -- excuse me, 11A-9?

MR. BALLANTINE: Yeah, I thought it was 9. I don't have it in front of me.

THE ARBITRATOR: It is 9.

THE WITNESS: I was referring to 9.

MR. STANTON: Which talks about services to a homeowner in effect on the date the ordinance codified became effective. So you're talking about services effective in 1979, right?

MR. BALLANTINE: Maybe you're right.

Q. In any event, there's also a provision that talks about, to the extent that there's a capital improvement passed through, that if the management doesn't essentially incur that expense then the management should discontinue the increase.

A. Right.

Q. Do you is see any reason why that wouldn't apply to a pass-through?

A. Well, the problem is it's not a capital improvement expenditure.

Q. Well, let's talk about that a little. I want to make sure I understand your position on that. I think you've agreed with me that the homeowners are better off if this is essentially treated like a capital expense pass-through because then it becomes a temporary increase and not a permanent rent increase, correct?

A. Right. Well, it should be amortized, it's not a recurring expense.

Q. Are you aware of anything in the ordinance, other than the language that it has regarding the capital expense regarding essentially passing through --

essentially amortizing an expense and making it temporary?

I guess my question is, isn't it the case that the capital expense provisions in the ordinance -- those are the provisions that analytically apply to all of the types of expenses we're talking about here under the temporary increases because they're all amortized over a period of time?

A. Well, I think this is a good analytical argument for that, but you know. It's not what the ordinance says, but someone could, you know, decide or a decision could even say, taking into account relevant factors, look, if you don't incur this expense, you only incur part of it, you've got to give the other part back, you don't get the other part. So I wouldn't say it comes from the capital improvement increase.

Q. All right. Fair enough. I don't think we dispute that.

Now, with respect to the anticipated professional fees relating to the rent increase, as I understand your position there, you don't necessarily quarrel with the idea that the park owner is entitled to recover professional fees relating to the rent increase?

A. That's right.

Q. Nor do you argue with the methodology employed here, which is to do it as a temporary as opposed to the base for a permanent rent increase?

A. Right, that's correct.

Q. And you don't object to amortizing it over a period of years?

A. No. It shouldn't be because it's not -- whatever you incur, you're not incurring it every year so it shouldn't be added on to the base rent.

Q. Right. So your sole quarrel is with the number?

A. That's correct.

Q. But it would be fair to say, you don't know exactly how much this park owner has incurred so far or what they're ultimately going to wind up incurring?

A. No. I'm just saying that $125,000 is way out of line with what's typical for rent increase applications.

Q. Well, but you don't know where this is going to go, do you? You don't know whether or not one party is going to take the writ to Superior Court or what kind of proceedings are going to follow from this, do you?

A. No. But I haven't seen a case where someone has comes with a rent increase application and built into the cost the fact that it might go up, be followed by a writ to the Superior Court. You know, the projected costs for going through the arbitration or the rent -- or before the rent board, not the second step that nobody knows whether it's going to occur or not.

Q. And I take it, you haven't done any studies of, around here, what rent increases have cost park owners?

A. No, I haven't done specific studies in this county.

Q. So you haven't looked at, for example, what Rancho Mobile Home Park in Goleta spent on its rent control litigation?

A. No. But the ordinances -- let me say this. The ordinances are very fairly similar statewide. Every ordinance is different, but they're fairly similar statewide. The legal fees, the hourly rates are about the same. $325 is not that much different in other cases. So I've said consistently where it's just gone through -- actually it's where it's gone through a more complicated step where the city has a lot of give and take about the application, the expense documentation, you know, the figures have been $30,000, $40,000, and here, with a much simpler procedure, I think, you've projected $125,000.

Q. So you would say that if this gets resolved that could be adjusted down to a specific number that is actually shown to be incurred?

A. Well, subject to the qualification that it needs to be reasonable.

Q. Okay. And I take it you wouldn't dispute that at the time that the property owner issued this notice of rent increase they didn't know to what degree they would wind up in these arbitration proceedings?

A. Repeat your last question.

Q. I guess my question is, wasn't it the case that at the time that the operator issued the notice of rent increase in January of this year, the ultimate costs of the professional fees relating to the rent increase was an unknown number?

A. That's correct, they didn't know. I would imagine they would have gotten an estimate.

Q. All right. What if that was the estimate of what it --

A. Well, I gave my answer. If it was the estimate, it's out of line with what is reasonable in the industry.

Q. And the estimates that you're talking about are limited solely to administrative proceedings and nothing further?

A. Right. I gave that table. Some of them had writs involved and they're much higher numbers.

Q. One was $175,000, for example?

A. Well, with two writs. But the others were just the administrative hearings. Some of them had two rounds of hearings. I don't mean just two days, but two rounds of hearings.

Q. And do you know of anything that prevents a park owner, if ultimately the expenses incurred do not equal that amount, from giving the tenants a rent decrease?

A. There's nothing to prevent the park owner, but on the other hand, the park owner, to get an amount that's totally out of line with, you know, what's reasonable or typical, you know, that wouldn't be reasonable. The residents pay $125,000 now, knowing that we're just going through this hearing before an arbitrator, and typically in these cases the legal expenses for similar proceedings have been, you know, $30,000 or $40,000. It would be out of line.

Q. Of course, at the times that the rent increase was done, the property owner didn't know if they would even be going through this proceeding at all or if they would be going to the Superior Court, correct?

A. Yes.

Q. So are you saying that the preferred practice it would be charge the homeowners after the fact and then risk another rent control proceeding following?

A. No, I would say the preferred would be at the end of this hearing to submit what the legal expenses -- I imagine, you know most of the legal expenses now because you have the all the expenses through today but not tomorrow. That's one thing, to see what they are.

And secondly, that they be subject to a reasonability standard. You know, if they're way out of line what is typical, it shouldn't be allowed. So if you come in and say, tomorrow, we've used up $100,000 in legal fees, I'd say, well, even if you really did, that's not reasonable.

Q. And you're basing that on kind of rules of thumb as opposed to any exact billing statements you've seen in this case?

A. I'm basing it on what I have seen in other cases.

Q. Right, not anything you've seen in this case?

A. Right.

THE ARBITRATOR: Mr. Ballantine, do you have an estimate?

MR. BALLANTINE: Yes, your Honor, I'm trying to wrap up now.

THE ARBITRATOR: All right, proceed.

BY MR. BALLANTINE:

Q. With respect to Dr. St. John's exhibits and his tables, Tables 3-A and 3-B, you heard him talk about the fact that he performed an analysis as specifically prescribed under the ordinance.

A. All right, what he's got --

Q. Do you want me to ask it again?

A. I heard --

THE ARBITRATOR: There was no question. It was a statement.

BY MR. BALLANTINE:

Q. Well, my question is, do you disagree with that?

A. That he's performing analysis according to the ordinance?

Q. Yes.

A. Well, let me say this. I've testified about the treatment of certain expenses, you know, whatever, and that's what I've disagreed with. Let me put it that way, that's what I have disagreed with.

Q. Well, I take it you've reviewed Dr. St. John's exhibits or Tables 3-A and 3-B, correct?

A. Right.

Q. And you have heard him testify about that?

A. Right.

Q. Do you disagree with Dr. St. John's testimony that he performed the analyses on those specifically in accordance with the requirement of the Santa Barbara Rent Control Ordinance?

A. Let me say this. I don't disagree. I'm not affirming that he followed them, but I don't disagree that he followed them because, you know, my analysis focused on specific issues.

Q. Can you point to anything which you can show that Dr. St. John did not follow the requirements --

A. No, I'm saying I don't disagree that he followed them. I mean, subject to my testimony.

Q. All right. And you heard him testify that the ordinance is not a classic MNOI analysis, it's a little different?

A. That's correct.

Q. Did you disagree with that?

A. Well, what's unusual about it is you have this thing of how you calculate the -- you have half the CPI increase that's used to cover increase in profit, the other half is to cover increase in operating expenses. That's unusual, yes, that's not classic.

Q. Do you disagree that we should follow the methodology prescribed by the Santa Barbara County Rent Control Ordinance?

A. No, no, I don't disagree.

Q. Just one final thing. Just so I'm very clear, you've said in your testimony you have indicated areas where you disagree with Dr. St. John. So I'm very clear, you can't point us to any single number here today in which you would say this is the correct number for a rent increase for Nomad Village Mobile Home Park in accordance with the requirements of the Santa Barbara County Rent Control Ordinance, is that correct?

A. I have not come up with a specific number.

MR. BALLANTINE: Thank you.

Thank you, your Honor, nothing further.

THE ARBITRATOR: Any questions on redirect?

MR. STANTON: I have a few, your Honor.

THE ARBITRATOR: Proceed.

REDIRECT EXAMINATION

BY MR. SANTON:

Q. Dr. Baar, I want to ask you about two areas. As to the item 6, anticipated professional fees, you were asked questions about the propriety of the park owner anticipating litigation costs or writs of mandate costs or multiple hearing costs.

My questions to you are, when an administrative hearing decision such as this is appealed to the courts, do the courts typically, if they find something wrong with that decision, remand it back to the administrative body for further or additional hearings?

A. Yes, that's the standard procedure.

Q. Do you have any knowledge as to whether or not, as part of that remand process, and at that time of the remand, that the park owner would then be able to claim additional expenses as they're then being incurred?

A. You can say that would be an additional clarification to make. In these cases, park owner claims expenses as to they've incurred as legal expenses for the application, and then if it goes to court and gets remanded back, then a second, additional claim is made at that time.

Q. So on remand, the park owner is able to calculate the additional expenses that are now being incurred, because of the litigation, correct, the appeal?

A. Right.

Q. And typically, the litigation in this case would be a writ of mandamus that would name the City as a party defendant, correct?

A. Yes.

Q. Because the hearing officer is employed by the

City and --

A. Right.

Q. -- the residents are real parties in interest?

A. Right. See, the park owner, their expense to date was $35,000. If they end up going to court and prevailing in a writ of mandate action, they are not boxed in, they can come back again.

Q. So in your experience, and let me ask you this first, since you're not disagreeing with the concept of doing this, I'm imagining that you have experience where you've seen other jurisdictions allow, in concept, these sorts of expenses at the initial administrative hearing, correct?

A. Yes.

Q. And in your experience, do these jurisdictions typically allow an estimate based upon worst-case scenarios that could include writs of mandate and remand hearing?

A. No, no. The only estimates are, let's say, they might allow an estimate for the last day.

Q. So again, what they are allowing is an actual calculation up through the end of that hearing with the idea that if there are more expenses they can be appended on when the case were to be remanded?

A. That's correct.

Q. And let me ask you, in your opinion, paying for the ability to appeal in advance, what, in your opinion, effect does that have upon the likelihood that an appeal would be filed, if a park owner knew in advance that they were already getting the money for the appeal?

A. Well, it's sort of a non-imaginable scenario.

Q. But wouldn't that encourage appeals to be filed where they otherwise might not be, if the park already knew the money to fund the entire appeal was in its pocket?

A. Well, it might be, unless they lost, they had to give it back. Put it this way, it's sort of an unimaginable scenario.

Q. I'd like to, secondly, go back to this analogy argument that Dr. St. John is using to, in effect, treat items such as the professional fees as the equivalent of the capital improvements or the capital items that the ordinance talks about, and you had some testimony that indicated, just now on cross-examination, that these are not capital items, all of those items down in items 4 -- excuse me, 5 and 6 are not capital items, correct --

A. Correct.

Q. -- the way the ordinance defines them?

A. Right.

Q. And there was some discussion about the fail-safe, if you will, of 11-6-A-5 that allows for the reimbursement of unused monies where capital improvements have not been constructed within six months, correct?

A. Right.

Q. And that's what you were referring to, correct, when you said that's sort of the protection that the residents have if these prospectively authorized funds are not used?

A. Right.

Q. Well, in that sub-section 5, it specifically says: "If managements fails to begin construction of a capital improvement." I guess my question is, do you have any opinion about how that section could apply where we're talking about professional fees, where they could be unconnected to construction of an item, how would that section, in your opinion, apply, if you have an opinion?

A. Well, the problem is with that is the root of the question has a certain presumption that you can estimate other costs and pass them through in advance, which generally hasn't been the practice in fair return cases, it's been limited to capital improvements and for a specific reason: People don't want to -- they want to give an incentive for capital improvements and people don't have incentives for capital improvements if they don't know if they're going to get their money back or what they're going to get for it, to protect or to encourage capital improvements, make them more feasible, but it hasn't been used for other types of expenses in general. I'm not saying it's a 100 percent rule because there's an exception to every rule, so as a presumption, you know, by logic you can say, well, we do it the same way for other expenses, they have to give it back. The logic has been for other expenses you can't -- you know, get them in advance, you know, you can't project in advance and cover a rent increase based on that or get an adjustment based on them.

Q. The last thing I'm going to ask you, you were asked a number of times whether or not you've reached an opinion as to some sort of dollar amount or whether you've done a calculation under MNOI, and you recall your responses to those questions, correct?

A. Right.

Q. So my question to you is, isn't it true, however, that based upon your testimony, that the ground lease expense should not be a part of the NMOI calculation? If that number were to be removed, hypothetically, you could calculate, could you not, what the end resulting number should be by simply removing that number?

A. Right. It would simply be a mathematical calculation.

Q. And you could sit here and perform that right now, but we're saying that would be an easy calculation to make, right?

A. Yes, it's a purely math calculation. The issue is -- the substantive issue is whether it should be allowed or not.

Q. I'll try to ask this the way I did on direct. It not your opinion that Table 3-B, which uses the 1994 base year comparison represents the correct calculation of the NOI at 75 percent indexing, except for the fact that we need it take out the lease payment, the ground lease payment item, and we reduce the calculation accordingly?

A. Well, the other thing I've got there, because the order, the timing, and all that, there should be an explanation about the dues, subscription and dues. Let's say apart from that, yes, you could just subtract that number from the number you've got on page 4 of that line 156.

Q. I think you already referred to that in your testimony.

A. Yes, it was about $73,000, if I remember correctly.

Q. And you indicated that that would make that number of $44.30 somewhere in the neighborhood of $4.00 or $5.00, I think, was your ballpark for that.

A. Right, I didn't say how much, but yes, small.

MR. STANTON: No further questions, your Honor.

THE ARBITRATOR: Mr. Ballantine?

RECROSS-EXAMINATION

BY MR. BALLANTINE:

Q. You didn't say a number for that, did you?

A. No.

Q. You haven't testified to a number, sir, of what you say is appropriate rent increase, correct?

A. No, I testified that you should subtract the lease payments from the $79,732.

Q. With respect to the expenses projected that haven't yet, necessarily yet been incurred at the time of the rent increase, is there anything in the ordinance that concludes that, can you point to anything?

A. No.

Q. Thank you.

A. I want to finish answering. I don't think any -- I don't remember ever seeing an ordinance that said you can consider expenses that haven't been incurred yet. Maybe there's an ordinance that says that, but I think when it said reasonable operating expenses, the presumption had been that, you know, they have been incurred. That's the presumption, that they're actual -- in fact, cities require in their rent increase applications, when they review them, they require documentation and proof that they have been incurred. That's been the standard practice.

Q. Sir, you would agree with me, we're not here under a city rent control petition, we're here under an arbitration and that's the only process we're reviewing, a rent increase, correct, under this ordinance that we're here under?

A. That's correct. But basically I'd say wherever it's been required, you know, it's been typical to say that expenses need documentation if they're contested.

MR. BALLANTINE: Thank you. Nothing further.

THE ARBITRATOR: Anything else?

MR. STANTON: I have nothing further. At this time, I'd like to move into evidence Exhibits 1 through 7.

THE ARBITRATOR: Mr. Ballantine, 1 through 7 or one at a time?

MR. BALLANTINE: I would note that I think they're completely irrelevant, but, if that's understood, I'll reserve that argument as to relevancy and I don't object to them coming in and the arbitrator see them.

THE ARBITRATOR: Thank you. I understand your position.

MR. STANTON: The objection goes to the weight? In other words, James, you're saying the objection goes to weight, correct?

MR. BALLANTINE: Yes. There may be some admissibility -- the problem would be admissibility, but I wanted to make sure I was clear I think they're totally irrelevant, but I won't object on that grounds. We'll argue it later.

THE ARBITRATOR: Thank you. So 1 through 7 are entered.

(Exhibits 1 through 7, inclusive,
were entered into evidence.)

THE ARBITRATOR: With that, off the record for a second.

(Discussion off the record.)

THE ARBITRATOR: I think, given where we are with that last witness, we'll break for today.

Margot, where will we be?

MS. WAGNER: We'll be downstairs in the Planning Commission hearing room, which is on the first floor and that's in the engineering building. So as you come up the elevator for this meeting, instead of getting on the elevator you'll continue and turn right just past the elevator and then straight on and you'll see it. It's very obvious. It's room 27. But it's very easy. If anybody gets lost, it's on the first floor of this building but it's technically in the engineering building versus this is the administrative building.

THE ARBITRATOR: We had a conflict with one of the parties first thing in the morning so we'll meet at 10:00 o'clock and we will estimate that we'll probably be done tomorrow. So we'll see you all tomorrow then.

MR. STANTON: For the record, may I indicate that I have delivered to the arbitrator, with a copy to counsel, a packet of a form that I created called "Designation of Representative" that's been dated and signed by 90 residents. I have attached these in sequential order, except the last two where the residents signed but the space numbers were not identified. So this, for the record, shows more specifically the 90 spaces that I'm representing in this proceeding.

THE ARBITRATOR: Do you want to move it as an exhibit?

MR. BALLANTINE: Sure, let's mark this as Exhibit 8.

THE ARBITRATOR: That's fine.

Any objection to marking Exhibit 8?

MR. BALLANTINE: Your Honor, I haven't looked at it. I don't think so. I'll look at it and if I see an issue I'll bring it to your attention.

THE ARBITRATOR: All right, it's marked.

(Exhibit No. 8 was marked for identification.)

Thank you and we'll see you tomorrow.

(The proceedings adjourned at 4:54 p.m.)

--o0o--

REPORTER'S CERTIFICATE

I, MARK McCLURE, CSR NO. 12203, a Certified Shorthand Reporter for the County of Santa Barbara, State of California, do hereby certify:

That, prior to being examined, the witness named in the foregoing deposition was by me duly sworn to testify the truth, the whole truth, and nothing but the truth;

That said deposition was taken down by me in shorthand at the time and place therein named, and thereafter reduced to typewriting by computer-aided transcription under my direction.

I further certify that I am not interested in the event of the action.

WITNESS my hand this 4th day of October, 2011.

J. M. McClure

Certified Shorthand Reporter in and for the County of Santa Barbara, State of California