

Attachment L
Nomad Village Mobile Home Park Rent Control Hearing
Transcripts 9-19-11

SANTA BARBARA SANTA MARIA
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ARBITRATION

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NOMAD VILLAGE MOBILE HOME PARK
RENT CONTROL HEARING

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Monday, September 19, 2011
105 East Anapamu Street
Santa Barbara, California

OUR FILE NO: 68763

REPORTED BY: MARK McCLURE, CSR #12203

ORIGINAL

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SANTA BARBARA, CALIFORNIA

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

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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.

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1 Mr. Stanton?

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

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

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

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

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

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

14 THE COURT: Thank you.

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

19 There are a number of residents here, there
20 are also some, I believe, persons from other nearby
21 local mobile home parks here as spectators. I'm here
22 along with Dr. Kenneth Baar, who is our expert. I have
23 obtained written designation of representation forms
24 from approximately 90 to 95 spaces, your Honor, which is
25 my habit of doing in hearings like this, just so that we

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1 can be absolutely certain who I represent. I viewed the
2 original of those this morning, they are being copied as
3 we speak, and by midday today I'll have the document
4 with a summary sheet on the front that indicates all the
5 spaces that have signed the representation form.

6 THE ARBITRATOR: Off the record for a second.
7 (Discussion off the record.)

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

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

24 MR. BALLANTINE: Thank you, your Honor.

25 Good morning. This is a hearing under the

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

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

14 The land is owned by the Bell Family Trust.
15 The Bell Family have been the longtime owners.
16 Mrs. Bell -- maiden name Botini -- it came down from her
17 family, and they initially leased it to the first
18 operator, Nomad Village, Inc., back in the 1950s, or at
19 least the principals of Nomad Village, Inc., in the
20 1950s, and they operated under a long-term ground lease
21 that expired on July 31, 2008, and that was Nomad
22 Village, Inc., the prior operator.

23 A couple things happened that are relevant to
24 the park proceeding today under the prior operator, and
25 it concerns the infrastructure of the park. The County

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1 had some issues in terms of the infrastructure of the
2 park that were discussed by the former operator, and the
3 former operator obtained plans for upgrades to various
4 infrastructure of the park.

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

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

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

24 One of the things that happened was they got
25 notification in about 2009 that there was going to be a

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1 significant property tax increase, and the reason for
2 that was because the County took the position that the
3 expiration of Nomad Village, Inc.'s, ground lease
4 constituted a change of ownership, and that change of
5 ownership triggered reassessment. As a result of that
6 reassessment that occurred at that time, property taxes
7 essentially doubled.

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

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

16 Secondly, at least since 1994, because, we
17 have records from 1994, the prior operator never sought
18 any kind of increase in the base rent other than the
19 annual CPI escalation that they're entitled to, which is
20 75 percent of the CPI.

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

25 Exhibit C is a document we'll be talking about

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

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

15 The permanent increase would be an adjustment
16 in the base rent going forward based upon the increased
17 operating costs and, as I indicated, we are not aware of
18 any such permanent space rent increase since the rent
19 control ordinance came into effect and certainly since
20 1994 at this particular park.

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

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1 supports the increase.

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

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

22 Secondly, there's a temporary increase, and
23 that has subcomponents to that. Now, the distinction of
24 the temporary increase is that it's something that's
25 temporary -- in other words, it goes on for a period of

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1 time and then it phases out entirely.

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

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

14 Second are professional fees that are about
15 \$50,000 that are legal fees relating to, essentially,
16 dealing with the County and other things relating to
17 legal work relating to infrastructure of the park.

18 The third area is the infrastructure, and it's
19 \$320,000. Now, let me talk about that. We'll have
20 evidence of exactly what that is. That is a payment
21 made by Lazy Landing into an escrow account. It was
22 paid in in 2008, and it specifically designated for park
23 infrastructure. None of the money has been spent yet,
24 although it's been paid in.

25 We'll also present to you and you'll hear some

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1 evidence of the work that's planned under that
2 infrastructure improvement. What's interesting about
3 this in this particular case is the monies are paid
4 in -- specifically paid in, and specifically designated
5 for the park infrastructure. So money hasn't been spent
6 on construction, but it has been drawn out of that
7 account, and we'll present what the evidence of that is.

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

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

18 Another component or aspect of that is that
19 since it's essentially retrospective in the sense that
20 you do the -- you notice the increase and then if
21 there's an issue with it, then you have a hearing, it
22 also provides that one of the things that a rent
23 increase notice can include is for proposed future work.
24 And the reason for that is because there's no petition
25 to bring in advance to ask to do the future work or to

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1 incur an expense in the future. So some of the
2 infrastructure extension is a future expense and the
3 ordinance specifically provides for that and it provides
4 that the park operator can collect for future expense,
5 and in the event that they do not incur that expense
6 within six months of the rent increase being final, then
7 they have got to pro rate -- they've got to do a rent
8 reduction until they actually incur the expense.

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

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

17 For the future expense you'll see some
18 invoices -- or excuse me, bids that will show work
19 that's being planned and what the costs are, and they
20 far exceed the \$320,000. There's things like some work
21 on transformers, the electrical system, and there's
22 things like a paving of the entire park. The paving
23 alone costs over \$400,000. It's far in excess of
24 \$320,000. You'll see about \$50,000 in costs incurred
25 towards the infrastructure by the operator to date.

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

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

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

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

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

19 And the final reason is that the assessor has
20 consistently treated the property owner as being the
21 Bell Trust and its predecessor and never the prior
22 operator, Nomad Village, Inc., under the theory that the
23 long-term lease, which expired on July 31, 2008,
24 constituted a change of ownership. The County would
25 have to recognize prior owner that was somebody other

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1 than the Bell Family Trust because their position is
2 that the change of ownership was from Nomad Village,
3 Inc., to the Bell Family Trust as of August 1st, 2008.

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

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

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

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

24 The final area of the temporary increase is
25 anticipated professional fees relating to the rent

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1 increase, and that was the idea that if, where there is
2 rent increase, there is expense related to rent
3 increase, and if there's a challenge, that would involve
4 a significant cost to the park, that would involve a
5 significant cost to the park, and that's included here.

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

10 One of the things about not including it, not
11 considering it to be a normal operating cost is actually
12 beneficial to the homeowners, and the reason why is
13 instead of those costs serving as a basis for a
14 permanent long-term rent increase, they are instead the
15 basis of a temporary rent increase. The thinking of the
16 park owner on that would be that it's unfair to impose
17 on the homeowners the basis for a permanent rent
18 increase for, really, costs that are unusual and
19 extraordinary, engaging in a piece or two pieces of
20 potential litigation that, at least as to those pieces
21 of litigation, one-time things, but they do involve a
22 significant and unusual expense, it makes more sense to
23 treat it as a capital expense than a temporary expense.
24 In other words, you just look at the expense itself, you
25 amortize it over a seven-year period, because that

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1 seemed to be an appropriate period, and so it's a
2 temporary expense for a seven-year period, and that's
3 the case for all of the temporary increases, the
4 proposed period is seven years and at 9 percent interest
5 rate, and I would note that the rent control ordinance
6 is very specific in providing for the ability to do
7 that. The idea that it's amortized over a reasonable
8 period of time and that there's a reasonable interest
9 rate attached to it, and the interest rate that we
10 attached to it was 9 percent.

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

16 Now, at the time that this was done this was
17 supported by an analysis by Dr. St. John of what is
18 called an MNOI analysis, maintenance net operating
19 income, and the idea is to look at that to see whether
20 or not the income of the park justifies the rent
21 increase, the net income of the park justifies the rent
22 increase. And I would note that that approach is an
23 operating expense based approach; you don't consider a
24 fair return on the actual investment, you don't say what
25 does the park owner has invested in it and what's a fair

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1 rate of return. It evaluates a fair rate of return
2 simply based on operating income. And at the time the
3 park did that fairly cursory MNOI analysis, that that
4 supported the \$58.16. Basically what it told us was
5 that the park was operating on a relatively marginal
6 basis prior to having the lease payment bump up and
7 double and the property tax effectively double, and by
8 having those additional expenses by essentially directly
9 including those in the increase, the MNOI analysis
10 suggested that was supported.

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

21 He prepared what we call an NOI analysis,
22 that's directly in accordance with the Santa Barbara
23 County Rent Control Ordinance and the methodology that
24 it prescribes, and you will hear more about the specific
25 methodology employed and that will show -- what he did

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1 was, Dr. St. John used two base years. What you do is
2 you do a base year and the current year, and you compare
3 the two years.

4 And he looked at two base years, he looked at
5 1994 under the past operator, and he looked at 2007, the
6 last year that the prior operator had it, and he
7 compared those. In both cases they came out very close.

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

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

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

25 Now, I just want to give you an overview of

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

9 I would also note that the rent increase that
10 was issued had a 75 percent of CPI component as part of
11 the permanent space rent increase, and that's referred
12 to as an automatic increase, which the park owner is
13 entitled under the rent control ordinance.

14 Dr. St. John's Table 2 talks about that CPI calculation.

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

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

25 And Dr. St. John's Table 4 talks about the

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1 temporary space rent increases, and he also provides, in
2 Table 5, an income and expense summary.

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

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

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

17 Exhibit H is the Lazy Landing ground lease
18 that was entered into and it's effective August 1st,
19 2008. I note it's an arm's-length transaction between
20 the Lazy Landing and the park owner, the Bell Trust.
21 And the primary reason for that lease is it shows two
22 things of relevance to us here, maybe three.

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

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1 negotiate for a lower number and was unsuccessful.

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

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

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

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

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

25 Exhibit K are essentially the capital expense

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

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

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

25 And Exhibit O are Nomad Village, Inc.'s, the

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

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

13 THE ARBITRATOR: Thank you.

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

19 MR. BALLANTINE: Yes.

20 THE ARBITRATOR: -- provisions?

21 MR. BALANTINE: Yes. I forget the exact, but
22 60 to 65 is where the change of ownership provisions are
23 and they have discussions about the change of ownership,
24 and in one of those sections is a discussion about the
25 fact that a long-term ground lease of 34 years or more

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1 constitutes a change of ownership, and it further
2 provides that the termination of a lease longer than 34
3 years constitutes a change of ownership.

4 THE ARBITRATOR: Thank you.

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

6 MR. STANTON: Thank you, your Honor.

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

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

19 The ordinance in question clearly applies to
20 this park which is located in the unincorporated area of
21 Santa Barbara County. The space rents in the park where
22 we have no long-term leases, as I understand it, that
23 exempt any space from rent control -- all 150 spaces of
24 the park would be subject to the ordinance -- and the
25 rents range from a low of \$287 to a high of about \$430,

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1 which makes the average space rent in the park
2 approximately \$315, pending the outcome of this
3 petition.

4 The noticed rent increase here that's at issue
5 includes the annual CPI adjustment at 75 percent of CPI.
6 75 percent is an important percentage number under the
7 ordinance because it's the indexing number, if you will,
8 that the County finds to be appropriate when determining
9 mobile home park rent increases.

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

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

22 The ordinance allows that annual adjustment
23 but it indicates that any rent increase in excess of
24 that 75 percent of CPI is subject to the petition rights
25 of the homeowners, and that's in fact why the petition

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1 was filed here. I think the petition probably on its
2 face was objecting to the entire notice, but for
3 clarity, it's only that part of the notice that exceeds
4 the 75 percent of CPI annual adjustment that the
5 homeowners seek to have reviewed by your Honor in this
6 matter. So that's the way that the ordinance works, the
7 annual versus what I would call a special rent
8 adjustment.

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

19 So that's what the ordinance allows and
20 provides for, and I think it's clear, notwithstanding
21 some arguments made in the initial objections filed by
22 the park owner, that we do have jurisdiction to proceed
23 here, the capital improvement, pass-throughs, as I would
24 call the temporary increases, and the permanent rent
25 increases clearly takes us above the 75 percent of CPI

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1 number, and I think that the City Clerk has verified the
2 signatures on the petition to be correct, so I don't
3 think there's any issue of jurisdiction here.

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

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

20 Essentially, the homeowners find this to be a
21 very interesting and, in my experience, having done many
22 of these hearings, a unique, if I can say, request for
23 an increase because it has very unique and interesting
24 components. In essence, there are some general
25 objections and observations that we have and then some

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1 that are more specific, and I'll try to, in my opening
2 statement, at least, talk about the more general
3 objections.

4 The "Permanent Rent Increases," as Exhibit C
5 reflects them, talk about a property tax increase and a
6 lease payment increase. There's a pretty definitive
7 calculation of that which just identifies an increase of
8 \$104,692 that's then amortized and gives you the \$58.16
9 rent increase amount that's labeled as the "Permanent
10 Increase."

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

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

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

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

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

25 But I think the intent is when looking at this

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1 maximum rent increase analysis above and beyond the 75
2 percent of CPI, the intent is to employ, in essence, an
3 NOI analysis. There are in most ordinances a list of
4 the expenses that should be included and the income
5 categories that should be not included -- included or
6 not included.

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

22 What we essentially have is a park owner who
23 negotiated this as part of his investment. This is an
24 investment expense, it's not an operating expense. What
25 we have is a situation where the rent doubled but it

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1 only did so at the time this park owner took over.
2 There was never any prior number this park owner paid
3 that was ever increased.

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

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

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

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1 each of those and show when it would be ending so
2 everybody knows when they're supposed to stop paying.

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

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

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

24 So one key question is how on earth can this
25 park owner pass through expenses that were incurred and

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1 paid for by someone else, and presumably would have been
2 the subject of any previous rent increase applications
3 or notices given during those years when Nomad Village,
4 Inc., the previous park owner, owned the park.

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

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

22 The idea is that the park buys the energy
23 wholesale and sells the energy retail, and the
24 differential to is to compensate the park for the cost
25 of maintaining, upgrading, repairing, et cetera, et

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1 cetera, its entire system. The serving utility has
2 nothing to do with the interior system of the park other
3 than to read the master meter at the street.

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

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

23 So as we go through this category, it's going
24 to be important to identify what, if any, of these past
25 incurred expenses relate to energy, sub-metered energy,

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1 and pull them out.

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

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

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

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

24 And as mentioned, our position is the lease
25 payment increase is not allowable, so to the extent that

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1 they're trying to get 34 months of uncompensated
2 payments -- I actually calculated it and it should be 33
3 months, but we'll be seeing about that -- but to that
4 extent, that would be improper.

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

12 The anticipated professional fees relating to
13 property taxes, which is item No. 5 on Exhibit C, the
14 \$50,000, I believe, refers to the potential appeal that
15 counsel has referred to. Again, we just don't know
16 anything about this. We don't know what the statute of
17 limitations is, we don't know whether any administrative
18 steps have been taken, whether any remedies have been
19 exhausted. Our questions would be things like if the
20 appeal went to the residents, get all these attorney's
21 fees back, if the park owner can recover its fees? We
22 don't know any detail. We don't know what the hourly
23 charge might be or what steps were really involved.
24 This really just appears to be a sort of, from the
25 homeowners' perspective, kind of an anecdotal request.

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

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

15 So the reasonableness factor of that, which
16 also the problem is that's completely unitemized at this
17 point, we have no idea what that number is, or is even
18 forecast to be, it's just a big lump sum thrown out
19 there, that's also, from our perspective, a huge issue.
20 As Exhibit D indicates that's a \$13.80 portion of the
21 \$102.84 temporary increase.

22 In sum, looking at this, when you take out the
23 ground lease payments, if those are to be excluded and
24 if any energy infrastructure for the sub-metered system
25 items are to be excluded, we have a significantly

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1 reduced rent increase that would be awardable and
2 justifiable.

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

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

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

21 Thank you.

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

25 MR. BALLANTINE: The ordinance?

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1 THE ARBITRATOR: Yes.

2 MR. BALLANTINE: That's fine.

3 (Exhibit Joint 1 was received into
4 evidence.)

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

7 MR. BALLANTINE: No objection.

8 (Exhibit Joint 2 was received into
9 evidence.)

10 THE ARBITRATOR: Okay.

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

16 MR. BALLANTINE: Sure.

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

19 MR. BALLANTINE: Thank you, your Honor.

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

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

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

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1 (A brief recess was taken.)

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

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

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

9 THE ARBITRATOR: Yes.

10 Sir, please raise your right hand.

11

12 MICHAEL ST. JOHN,

13 Called as a witness,

14 having been sworn, was examined

15 and testified as follows:

16

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

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

21 THE ARBITRATOR: Mr. Ballantine, you may
22 proceed.

23 MR. BALLANTINE: Thank you, your Honor.

24

25 DIRECT EXAMINATION

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1 BY MR. BALLANTINE:

2 Q. Dr. St. John, what is your profession?

3 A. I'm an economist.

4 Q. Can you tell us a bit about your background in
5 becoming an economist? Start with educational
6 background, please.

7 A. Yes. I went to UC Berkeley and got a master's
8 in economics in 1984 and Ph.D. in economics in 1989.

9 Q. And tell us, did you have an undergraduate
10 degree before going to Berkeley?

11 A. I had a B.A. from Harvard College.

12 Q. All right. And as an economist, have you
13 focused your area of study in any particular areas?

14 A. Rent control, one could say.

15 Q. Okay.

16 A. My dissertation was on the effects of rent
17 control on property value.

18 Q. Tell us a little bit about your academic
19 experience in the area of rent control studies.

20 A. There are no courses in rent control at
21 graduate schools, so I studied microeconomics, I studied
22 regulatory economics, but there was no coursework
23 explicitly on rent control.

24 Q. Have you, then, either during the course of
25 education or subsequent to that, performed any studies

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1 and written any scholarly reports on rent control
2 issues?

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

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

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

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

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

21 Q. So -- I'm sorry.

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

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1 Q. And speaking of your bio, let me direct your
2 attention to Exhibit E in the binder.

3 A. Yes.

4 Q. And we've got a biographical note. Is that a
5 biographical that summarizes your work in the rent
6 control area?

7 A. Yes.

8 Q. Yes.

9 A. You know, when I came up to this stand I
10 didn't bring my glasses and it would be very helpful if
11 I got them.

12 Q. Go ahead.

13 A. All right.

14 Q. Okay. Now that you have your glasses, does
15 Exhibit E look familiar?

16 A. Yes.

17 Q. This is a summary, the first page,
18 biographical note, is that a summary of some of your
19 background and experience in rent control?

20 A. Yes, it is.

21 Q. And I think this is the biographical note from
22 the article you just referred to, "Fair Return Under
23 California Courts."

24 Then the next page and the following pages, is
25 that, essentially, your CV?

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1 A. Yes, it is.

2 Q. So you've served as an expert witness in
3 mobile home rent control proceedings, is that correct?

4 A. I have several times.

5 Q. And you have also been hired as a consultant
6 for municipalities?

7 A. Yes.

8 Q. Has that been in the area of mobile home rent
9 control as well?

10 A. Yes. I was about hired by the City of
11 Lancaster, I was hired by the City of Marina, and by --
12 I can't recall if it was the City of Santa Rosa or
13 Sonoma County, they have combined rent control system
14 and I don't remember which one of the two hired me.

15 Q. Okay. And you indicated you appeared in a
16 number of key lawsuits relating to mobile home rent
17 control?

18 A. That's true.

19 Q. And you listed some of them here on the last
20 page of your CV?

21 A. Yes, that's true.

22 Q. Are you familiar with what Mr. Stanton was
23 talking about, the MNOI analysis, are you familiar with
24 that?

25 A. Yes.

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

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

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

7 A. It is.

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

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

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

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

23 A. Well, the typical fair return on investment
24 system, one actually uses the investment amount and the
25 rate of return, would do the math and would say the park

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1 owner deserves that rate of return, depending on fair
2 rates of return. In other words, it would be a rate of
3 return analysis. There are several varieties of that,
4 but in a nutshell, is what a fair return on investments
5 system would look like.

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

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

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

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

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

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

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

9 A. Yes. I do them often.

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

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

17 Q. Ground lease expenses are included?

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

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

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

11 A. Yes.

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

15 A. Yes.

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

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

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

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

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

16 It says that the arbitrator is --

17 THE ARBITRATOR: Hold on. Off the record.

18 (Discussion off the record.)

19 THE ARBITRATOR: All right.

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

23 Q. Dr. St. John, I was asking you if you would
24 please compare and contrast what you termed the classic
25 MNOI analysis versus the Santa Barbara County ordinance

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1 system which you've kind of characterized as a little
2 bit of a hybrid or variation on the classic MNOI
3 analysis.

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

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

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

24 Q. And does the ordinance specifically identify
25 as a property tax -- increased property tax expense as

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1 one of those expenses to consider for the purposes of a
2 rent increase?

3 A. I believe it does.

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

6 A. I don't think so, no.

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

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

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

14 A. It does.

15 Q. Tell us a little bit about that.

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

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

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

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

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

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

3 A. Yes.

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

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

13 Q. Anything.

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

16 Q. Maybe it is specifically capital improvements.

17 A. Uh-huh.

18 Q. We can come back to that.

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

23 A. Yes.

24 Q. Can you just give us an overview of the types
25 of things you did and then we'll get into the details of

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1 the analysis, but give us the forest for the trees.

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

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

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

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

23 Q. And that reminds me. Let me ask you one other
24 question about the Santa Barbara County ordinance
25 overall. You testified a few minutes ago about a

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1 specific procedure that the arbitrator is to follow
2 regarding making its determination as to the amount of
3 rent increase that's appropriate in this circumstances.
4 Do you recall that discussion?

5 A. Oh, yes.

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

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

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

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

24 But Table 5 doesn't have any analysis, it's
25 not adjusted in any way, I didn't manipulate those

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1 numbers, that's just a matter of getting the books of
2 record from the current operator and the old operator
3 and then putting them down in consistent format on one
4 page -- well, it's actually more than one page now, but
5 putting them down in one spreadsheet so that they can be
6 compared year by year by year so they make sense.

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

18 This ordinance, like many ordinances, says if
19 there's anything particularly unusual about the base
20 year that the arbitrator can make adjustments. So
21 having those years that surround the base year we've
22 chosen -- we'll get to that in a minute, I'm sure, about
23 the choice of base year, but having those years that
24 surround it is useful because someone might say, oh, the
25 figure for administration was too high that year, or too

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1 low, and this allows anyone to take a look and see, is
2 it comparable, roughly comparable to other surrounding
3 years.

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

9 A. Yes.

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

12 A. Well --

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

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

18 Q. Yes.

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

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

25 THE WITNESS: Thank you.

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1 BY MR. BALLANTINE:

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

6 A. Okay. The first step was to sort out from the
7 property taxes the sewer fees because they happen to be
8 billed on the property tax bill, so these, at the top
9 there, you see for 2008 and 2009, \$50,145 in the case of
10 2008, and \$54,588 in the case of 2009, subtract it out
11 in order to get to C, what the taxes were, just the
12 taxes. And in 2008, the taxes were \$20,453, and in 2009
13 they were \$66,523, an increase in that time period of
14 \$46,070.

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

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

23 There was some complexity because taxes are
24 billed on a fiscal year basis, taxes go from July 1 of
25 one year through June 30 the next year. That's the way

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1 they're billed, but they're paid in certain calendar
2 years. So, for example, in 2009, typically, a park
3 would pay, early in 2009 they would pay the second half
4 of the 2008-2009 property tax bill, and then later that
5 year they'd pay the first half of the 2009-2010 property
6 tax bill. So the amounts that are paid, the actual
7 checks that are written don't exactly match the amounts
8 billed, and so that's a complexity that has to be worked
9 out.

10 Q. Did you work out that complexity?

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

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

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

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

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

25 A. Well, you know, I would have to look because,

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1 from what I just said, these are tax bills and sewer
2 fees and, therefore, taxes. These are those fiscal year
3 summaries. In effect, these amounts of taxes surely
4 were paid, but they were not paid in these amounts. I
5 don't think you'll find a check for \$20,453 in the books
6 of record anywhere because the amount that was paid in
7 2008 would have been half of the 2007-2008 bill and half
8 of the 2008-2009 bill, so it would have been slightly
9 different. It doesn't make much difference year by year
10 by year because the taxes only go up by 2 percent, but
11 it makes a big difference between, for example, 2007 and
12 2010.

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

15 A. I did. The taxes were paid.

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

19 A. Well --

20 Q. What would happen?

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

24 Q. Okay. And let's address one thing that came
25 up in opening. You have a note regarding No. 1 -- well,

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1 regarding the property tax increase, and the note is the
2 No. 1, correct?

3 A. Yes.

4 Q. And tell us about that note.

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

11 Q. Fair enough. Go on.

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

16 THE ARBITRATOR: Counsel, would you approach,
17 please.

18 Off the record.

19 (Discussion off the record.)

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

22 MR. BALLANTINE: Thank you, your Honor.

23 Q. We were talking about this property tax
24 increase. Summarizing, Dr. St. John, would it be fair
25 to say that in the spreadsheet that you prepared, you

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1 were signalling to the residents that there was a
2 challenge to the property taxes that was contemplated
3 being pursued, and that if that challenge were
4 successful then the rent increase amount would not be
5 passed through to the residents?

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

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

9 A. Oh, yes, we talked about that.

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

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

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

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1 A. Yes.

2 Q. And with respect to the increase, did you
3 perform an assessment and determine that that was an
4 appropriate expense to pass through to the residents?

5 A. Yes.

6 Q. And that would be under the applicable
7 ordinance?

8 A. Yes.

9 Q. All right. So would it be the case that you
10 determined these two items and you got a number, the
11 \$104,000, and from that number you came up with what
12 that would work out to be as a specific rent increase
13 per space?

14 A. Yes. And I should point out that Table 1
15 gives the per-space-per-month analog, and had I thought
16 about it at the time, I would have put on this chart,
17 but I didn't. Actually, at the meet and confers, as I
18 recall, the residents asked that I put it on this chart
19 and that's why our -- it is shown on the current tables
20 that we're using.

21 Q. And by that you mean, that would be just the
22 sub-breakdown between, for example, what we've looked as
23 permitted items 1 and 2, is that correct?

24 A. Well, I'm just talking about the fact that
25 column H on this page, Exhibit C, just gives the dollar

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

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

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

8 Q. For the line item, right.

9 But we can see that in Table 1?

10 A. Yes.

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

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

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

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

22 A. Well, can I ask your question this way?
23 First, talk about the amortization as a general
24 category. Do the amortization calculations apply to
25 items 3, 4, 5 and 6? So the ordinance makes it clear

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1 that for capital improvements amortization is
2 appropriate, and what amortization means is spreading
3 the cost item out over several years and then having it
4 terminate then at that time.

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

16 I've seen amortization periods considerably
17 longer and some somewhat less. Residents, interestingly
18 enough, sometimes argue for shorter rather than longer
19 because residents understand that if it's amortized out
20 over a longer time period they're going to pay more
21 interest in the long run and are therefore willing to
22 pay a larger amount sooner in order to have a lower
23 amount later. But some residents don't feel that way
24 and they want the lowest dollar amount possible right
25 now. So these things are debatable and they are often

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1 debated, but 9 percent and seven years seemed like an
2 average kind of figure to use.

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

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

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

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

22 A. Yes.

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

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1 planning and permitting?

2 A. That's right. The \$90,000 for A&E, the
3 \$50,000 for professional fees and the \$320,000 for
4 infrastructure costs were all given to me, and that's
5 why I put them down there.

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

9 A. Yeah, I've seen this statement.

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

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

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

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

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

24 A. Well, the tax increase computed at the top is
25 \$46,070 being incurred at the time that the park came

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1 under new management.

2 Q. And that was August 1st, 2008?

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

5 And the County isn't quick, usually, in
6 changing the tax rates, they wait a while and then they
7 eventually change the taxes and then they send our
8 supplemental tax bills. So I use the term
9 "supplemental," but that's not -- I don't mean to say
10 the supplemental tax bill, I mean to say that the extra,
11 the increased tax amount was \$46,070 between 2008 and
12 2009.

13 Then the question is, how long will it be
14 before the park owner begins being compensated for that
15 tax increase? And the answer is, until May 1, 2011.
16 The increases that were imposed, effective May 1, 2011,
17 covered that amount, so from then forward the park owner
18 is whole, but for the period from August 2008 to May
19 2011 the park owner was obligated to pay these amounts
20 but the residents were not obligated -- before this
21 proceeding, or otherwise, wouldn't be obligated to pay
22 it.

23 But in my view, these are amounts that
24 residents, in the end, have to pay. This is an
25 increase, it's a legitimate increase, it's government

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1 imposed, it's not within the park owner's discretion, it
2 is an extra cost.

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

21 Q. Regulatory lag?

22 A. Regulatory lag. And the PUC knows all about
23 it, and PG&E and the other electric utilities and the
24 other utilities, they argue this all the time, and they
25 talk to the PUC and they say, wait a minute, you're

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1 giving us an increase from now forward, but what about
2 the time in the past? And it's my understanding that
3 normally some adjustments are made in order to cover the
4 time in the past when some costs may have gone up by an
5 unusual amount.

6 Well, the increase in property taxes by almost
7 \$50,000, that's certainly an increase in an unusual
8 amount. It's a heavy expense that the park owner has
9 been incurring ever since 2008 and that's why, in my
10 view, there should be this extra amount.

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

19 I mean, the first judgment call that the
20 arbitrator will be considering is whether it should be
21 allowed at all in this matter, but the second question
22 is how should it be done, should it be done more quickly
23 or more slowly. Partly for ease of computation, and I
24 did all of the amortizations on this page using the same
25 rate, 9 percent, and the same number of years, seven

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1 years, and people could have differing opinions for each
2 of these items, No. 3, 4, 5 and 6, and it would not be
3 hard to adjust the amortization calculation for each of
4 them if we were to decide that some different time
5 period or rate was appropriate, more appropriate for one
6 or another or all of them. I can't say that there's
7 anything particularly appropriate about 9 percent and
8 seven years for item 4, but it seems like an amount that
9 the park owner is willing to agree to and so I'm
10 approaching it that way.

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

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

22 A. Right.

23 Q. And in terms of regulatory lag, essentially,
24 that's the difference between the time that the park
25 operator first incurred the number to the time that it

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1 could go through the regulatory process and begin
2 recovering that cost. Is that a fair summary?

3 A. Yes.

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

10 A. Yes, H-8.

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

13 A. Yes, uh-huh.

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

17 A. That's right.

18 Q. And then you multiply that number by the
19 34-month gap and you got a total of \$130,000?

20 A. Yes.

21 Q. All right.

22 A. Can I interrupt to say, Mr. Stanton said he
23 thought it was 33. He could be right. I wasn't 100
24 percent certain what the date -- when I did this
25 calculation, I wasn't 100 percent certain what the date

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1 of transfer was so I didn't know when the property
2 tax -- the taxing authority would begin, and so we could
3 revisit that question as to whether it would be 33
4 months or 34. I'm not able to tell you at this moment
5 for sure that it's 34 or 33.

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

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

12 And just to complete the math, so we take the
13 34, in this case, and we multiply it by the monthly, and
14 that comes out, in the case of the tax increase, to
15 \$130,531.

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

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

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

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

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

14 A. That's right.

15 Q. And so that gets us to a number almost
16 \$300,000. And you took that number, basically amortized
17 it over seven years, applied a 9 percent interest factor
18 and you got a number of \$58,937?

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

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

24 A. Yes.

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

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1 1 quickly just to compare that, you also, then -- Table
2 1 is the same thing or the same concept, the same
3 information as Exhibit C, this just gives us a breakdown
4 per space per month of these sub-items, correct? So in
5 other words, under "Uncompensated Increases," that comes
6 out to roughly \$32.74 per month per space on that
7 sub-item?

8 A. Yes.

9 Q. All right. So does that mean if we're off by
10 a month, 33 instead of the 34 we were working with,
11 you'd have something in the neighborhood of a dollar?

12 A. Yeah, that's right, it might make a difference
13 of about a dollar.

14 Q. All right. Let's move on, then. But just so
15 I'm clear, so this No. 4, the total, that we did this
16 with a sub-number as part of the \$102 rent increase
17 pursuant to the notice?

18 A. Yes, it's one component, one of four pieces
19 adding up to \$102.84.

20 Q. In your professional opinion, was it
21 appropriate for the park owner or the park operator to
22 recover this, essentially, this regulatory lag?

23 A. Well, I think so. I mean, I can see that some
24 people might think not, and it could be debated, but
25 yes, I think so for the reasons I just explained.

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

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

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

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

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

6 A. Yes.

7 Q. And how did you treat that?

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

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

19 A. It is the number I was given.

20 But can I return for a moment to item 5?

21 Q. Yes.

22 A. I want to say a little more about that. In my
23 experience, if an amount like \$50,000 were to be
24 incurred in one calendar year, and if that turned out to
25 be the comparison year for an application in this

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1 jurisdiction or any other, Dr. Baar, I fully believe, or
2 any consultant for the homeowners would probably object.
3 They would say no, no, that's too big. It's an unusual
4 item and you can't -- you shouldn't leave it in the
5 calculations because that means that, in effect, the
6 arbitrator would be adding that amount to the budget for
7 the park for every year thereafter. And I would
8 basically agree with that judgment. So the shoe is on
9 the other foot. We're talking now about --

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

15 A. That's right. And let me make my hypothetical
16 a little different and maybe a little tighter. If we
17 actually did this and, let's say, we spent \$50,000 in
18 2012 on the property tax issue, and let's say in 2013 we
19 apply for remedies. I'm saying that Dr. Baar, if he was
20 a consultant at that time for the residents, he'd
21 probably say that's too much, you can't do that all in
22 one year, it should be amortized, and all I'm just
23 saying is yes, I agree with what I think he would say,
24 that it should be amortized and therefore, instead of
25 putting it into the -- well, what I'm saying right now,

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1 actually, is more appropriate for item 6. But
2 instead -- I'll just finish what I was saying. Instead
3 of putting it into the budget wholly unamortized, I'm
4 suggesting that we amortize it. I'm suggesting that in
5 advance.

6 In category 6, for example, some piece of this
7 \$125,000 were incurred in 2010. They were fees paid to
8 myself for doing the calculations here, and some other
9 amounts were paid, I believe, to the park's attorney for
10 work he did in preparation for this hearing.

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

20 So anticipating that conclusion, which
21 actually I agree with, we pulled them out -- we'll get
22 to this in a minute and I'll be able to show exactly
23 where we pulled them out and how much -- I'm just trying
24 to explain why some expenses are amortized, and partly
25 I'm explaining this because the ordinance doesn't talk

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1 about amortization in this manner. The ordinance
2 actually doesn't lead us down this road.

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

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

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

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

24 Q. Essentially, you made a distinction between
25 either treating it as a normal operating expense,

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1 treating these expenses as a normal operating expense
2 for the purposes of calculating a permanent rent
3 increase under MNOI or pulling it out and making it
4 something separate, essentially. Is that correct, a
5 fair distinction?

6 A. It is a fair distinction.

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

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

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

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

25 So --

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

12 A. Correct.

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

16 A. That's right.

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

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

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

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

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

3 A. Yes.

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

7 A. Yes, I prepared all of these.

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

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

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

19 A. Yes.

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

24 Let's move on to Table 3-A and 3-B, which are
25 two groups of tables here comprising several pages. Can

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1 you tell us what those are?

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

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

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

20 Q. Okay.

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

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

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

7 A. Yes, that's right.

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

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

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

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

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

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

5 Q. Is that pretty typical in your experience?

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

13 For example, looking on page 1, you'll see
14 that many of the line items are preceded by a number --
15 4100, 4310, 4300, et cetera. Those numbers are used by
16 Waterhouse Management in its books of account, and
17 that's one system.

18 The prior operator didn't use that numbering
19 system. The prior operator used some -- named things,
20 sometimes, differently, and amalgamated things,
21 sometimes, differently. For example, going down the
22 page, we see that the line item 5200 is wages for the
23 managers, line item 5210 is wages for maintenance, and
24 if you'll see column F has numbers it because that's
25 2010, but column E has, has no numbers in it. The

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1 reason is that, if you look down below, line 38, wages,
2 \$113,000. So in other words the prior operator's
3 accounting system had wages of all types lumped in and,
4 as we'll see later, it covered not only on-site
5 management but maintenance and some other kinds of
6 management.

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

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

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

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

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

18 A. That's true.

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

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

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1 A. Yes.

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

4 A. Yes.

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

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

10 Q. Okay.

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

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

22 A. Yes.

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

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1 A. I did.

2 Q. And going down the page under "Expenses," we
3 can see you excluded those expenses as well, correct?

4 A. Yes. It's common in these sorts of analyses
5 to exclude gas and electric income expenses completely.

6 Q. And so I think really those are the larger
7 numbers under income. If we go down under "Expenses" --
8 I think we've talked about that on the first page.

9 Why don't we go to the next page. Basically
10 you have exclude some expenses as well that you thought
11 were appropriate to exclude on the second page, correct?

12 A. That's right.

13 Q. Let me ask you about two of the larger ones
14 town here. We have legal-general and management fees.
15 Tell us about those.

16 A. Well, the legal-general are fees, I believe --
17 I think we'll find that very number on Table 4. I know
18 we haven't gotten to it yet.

19 Q. Maybe we've rounded that down.

20 A. Yeah. I think legal-general are mostly fees
21 having to do with preparing this application and the
22 decision was that it would be -- it should be amortized,
23 and that's why we took it off.

24 Q. All right.

25 A. Let's see what the footnote says. The note

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

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

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

16 Q. All right. And just for point of
17 clarification, I think what Mr. Garcia talked about,
18 that actual fees were under capital improvements, the
19 \$50,000 basically related to the capital?

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

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

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

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

11 A. I believe so.

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

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

25 Then what I noticed was no line items for

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1 management fees. It seemed to me likely that the wages
2 covered management fees. I might say --

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

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

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

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

22 A. That's what it seemed to me.

23 Q. All right. So let's go on to the next page.
24 And I want to ask you a few things. Line 98 you have
25 property taxes. I take it those are the property tax

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1 numbers that we have been talking about before the
2 increase. You've got the lower number and then the
3 increased number, correct?

4 A. Yes.

5 Q. For 2007 and 2010?

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

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

15 Q. Okay.

16 A. These are amounts that were actually paid.

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

20 A. They are. In an attempt to clarify, you may
21 notice that line 98 and 99 are both labeled with the
22 number 5900, And that's because I simply broke category
23 5900 into two pieces, the \$66,485 for property tax per
24 se, and the \$15,766.98, which was a supplemental tax
25 bill from a prior year.

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

3 A. I took that one out.

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

8 A. Yes.

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

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

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

18 A. Right.

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

25 A. Yes.

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

3 A. Yes.

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

7 With respect to the line item 104, "Accounting
8 and Legal" from the old operator, you reduced from
9 \$84,000 to \$10,000. Why was that?

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

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

23 A. Right.

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

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1 2008, showed an income of about that amount, \$112,000, I
2 forget, \$112,000 or \$114,000?

3 A. In the subsequent year.

4 Q. In the subsequent year.

5 A. Exactly. So that amount was reimbursed.

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

9 Q. Okay.

10 A. So we shouldn't be charging the residents with
11 \$84,000 that was spent in that year because it got paid
12 back.

13 Q. Got paid back the following year?

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

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

25 A. Correct.

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

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

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

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

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

17 A. That's true.

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

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

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1 Q. Yes.

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

4 The next line, 141, does the math to compute
5 the fact that it was a 4.2 percent CPI increase between
6 2007 and 2010.

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

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

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

14 So the CPI-justified space increase would be
15 \$16,823.

16 And then line 145, tracking the ordinance
17 method, divides it by two, and so that number is
18 \$8,411.51.

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

24 So then we look at the cost increases. Line
25 149, has basic operating year costs, line 150 has

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1 comparison year operating costs, line 151 subtracts the
2 one from the other, to define the excess -- I'm sorry,
3 to find the increase in operating costs, which is
4 \$119,881 and change. Then line 152 shows the excess
5 increase in operating costs over the amount in 2, above,
6 which the arbitrator is to designate for cost increase.

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

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

16 Q. So that's the sum of essentially the two
17 \$8,411's and the \$111,469?

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

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

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

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

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

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

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

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

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

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

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

25 A. Yes.

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

4 A. Yes.

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

11 A. That's correct.

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

14 A. That's right.

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

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

23 There is no logical justification in economics
24 or finance for using anything other than 100 percent
25 CPI. There are CPI calculations done in our economy for

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1 teachers' salaries, for government contracts, for union
2 negotiations, and there is no other context in the
3 entire American economy, other than rent control, where
4 any number other than 100 percent of CPI is used.

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

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

18 Santa Barbara County is not alone in
19 articulating what we call partial indexes -- in other
20 words, some other number than this the CPI -- but the
21 fact that Santa Barbara County is not alone doesn't
22 justify it. It's not justifiable in any jurisdiction.
23 It's not ever justifiable, because less than 100 percent
24 CPI is completely incompatible with a fair return. You
25 cannot allow -- calculations will never allow fair

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1 return if they're done at anything less than 100 percent
2 indexing. Do you understand the phrase "100 percent
3 indexing"?

4 Q. I do.

5 A. Okay.

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

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

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

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

4 A. Yes.

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

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

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

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

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

6 But Mr. Stanton in his brief, he asked why
7 1994? And it was a good question, so I thought some
8 more and it occurred to me that another base year that
9 really makes very good sense is 2007, because it's the
10 last -- I mean, the reason we're here is because the
11 park changed hands, because the park changing hands
12 created this lease increase --

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

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

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

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

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

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

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

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

24 A. Yes. That's the difference.

25 Q. And then I won't spend much time going through

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1 this at all, certainly not the first three pages, but
2 for the purposes of question right now, because I think
3 it will helpful, is look at page 4 and again I'll ask
4 you in a summary fashion, would page 4 of the '94 base
5 year analysis in chart 3-B contain the same analysis --
6 that is the same process -- for computing these
7 calculations as Table 4 in -- excuse me, page 4 in Table
8 3-A?

9 A. Yes.

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

16 A. Yes.

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

18 A. Yes.

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

22 A. Yes.

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

25 A. It is. I mean, it's off by five cents, so

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

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

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

23 A. That's correct.

24 Q. Would that be a further indication of why, in
25 your opinion, 2007 is the most appropriate year to use

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1 in performing this analysis?

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

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

10 A. That's true.

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

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

14 Q. Based on this NOI analysis type of analysis?

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

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

21 A. Yes.

22 Q. Not the capital expense?

23 A. That's right.

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

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

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

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

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

11 (The lunch recess was taken.)

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

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

20 MR. BALLANTINE: Right. Your Honor, that's
21 about the -- I think that's to formalize the fact that,
22 as to what we call the automatic rent increase pursuant
23 to 75 percent of the CPI, that's a little tricky because
24 it varied by space, but as an exemplar, in Exhibit B, we
25 have, I guess, some numbers. We have some numbers of

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1 what those would be, and then an increase. The
2 increased dollar amount is space specific, but the
3 percentage numbers for the three years in question would
4 be the same.

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

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

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

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

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

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

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

24 THE ARBITRATOR: Thank you for that. Here's
25 how I handle witnesses out of order. Towards the end of

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1 the day, particularly if they can't come back, I take
2 the time remaining, cut it in half and make sure both
3 parties have a chance to take a shot at the witness. Is
4 that satisfactory?

5 MR. BALLANTINE: Yes.

6 MR. STANTON: That's fine.

7 THE ARBITRATOR: Thank you.

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

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

12 Sir, you recognize you're still under oath?

13 THE WITNESS: Yes, I do.

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

16 MR. BALLANTINE: Thank you.

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

25 A. Yes.

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

3 A. Yes.

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

7 A. They're excluded.

8 Q. Excluded?

9 A. Excluded.

10 Q. And can you show us where that is?

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

13 Q. Oh, okay.

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

16 Q. Let's do it now.

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

20 Q. Yes.

21 A. That number doesn't appear. These two
22 sections, "Other Income" and "Other Expense," in Table
23 5, don't appear at all in Tables 3-A and 3-B.

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

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

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

9 A. Yes.

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

12 A. Right.

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

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

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

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

23 A. Oh, yes.

24 Q. And you confirmed that they essentially
25 approximately doubled?

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1 A. That's true.

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

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

8 Q. And --

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

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

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

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

22 A. Yes.

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

25 A. It's my understanding the money has been

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1 deposited into an escrow account. None of that money,
2 as far as I know, has been actually used on capital
3 projects yet, but it's designated for that purpose.

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

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

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

14 A. Yes.

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

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

22 Q. Okay.

23 A. So this is simply the books of record
24 translated into a single table and it does the math
25 between the two operators so that column F and G, you

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1 may notice that they're in smaller print, and they're
2 italicized and that's because they're each a half year,
3 and then they're summed in column H as the full year.
4 So those two, F and G, those two columns, half year
5 each, roughly half year each, one from the books of
6 record of Nomad Village and the other from the books of
7 record of Lazy Landing.

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

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

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

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

18 Q. Okay.

19 A. It also has the advantage, as I think I
20 mentioned before, that if anyone was curious about a
21 particular line item, they can look, in the case of
22 2007, they can look on the previous and the year right
23 after and see if the number in question differs
24 radically from surrounding years. And in the case of
25 2010, of course, one could look back to 2009 and see if

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1 that is close.

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

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

7 A. Yes.

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

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

20 Q. All right.

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

25 Q. So the first page here of this group, at least

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1 in 2007, would be 2007-2008, correct?

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

4 Q. I'm three pages in?

5 A. Three pages in, yes. 2007 is really
6 2007-2008.

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

10 A. Yes.

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

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

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

19 A. Yes.

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

22 A. Yes.

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

25 A. Yes.

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

2 A. Yes.

3 Q. All right. Then Exhibit H, this is the ground
4 lease for Lazy Landing, and this talks about -- on page
5 1 it states that 20 percent of all collected rents from
6 the property?

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

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

13 A. I didn't.

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

17 A. It wasn't.

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

21 A. Yes.

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

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1 A. Well, there were none in effect in 2010.

2 Q. I guess I mean on a going-forward basis.

3 A. Well, I didn't project going forward, so it
4 would be there. And it is interesting to note that the
5 20 percent, by contrast, is going through to any of
6 these amounts.

7 Q. Okay. So that's an additional rent, though,
8 that your calculations don't factor, at this point?

9 A. At this point.

10 Q. To the degree that there are capital
11 improvements pass-throughs that increase the rent, then
12 your calculations don't essentially anticipate that?

13 A. That is true.

14 Q. Like I said, I didn't want it take a lot of
15 time on these, but let's go to Exhibit I.

16 This is the Nomad Village ground lease. I
17 think it's on the second page but it's basically 10
18 percent.

19 A. You know, I've never seen that before today.

20 Q. Okay.

21 A. So as to my testimony, I don't think it would
22 really help. The numbers I used were into a calculation
23 based on 10 percent, I simply used the number in the
24 book of accounts.

25 Q. That's fair enough. So your calculations were

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1 based on actual rent amounts incurred?

2 A. Actual, not calculated.

3 Q. All right, thank you.

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

11 A. That's my understanding.

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

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

20 Q. Okay.

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

25 Q. Yes.

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

4 Q. Right.

5 A. The escrow account is, I think I remember,
6 \$327,000 and change, and here it's \$320,000.

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

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

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

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

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

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

3 Q. I am.

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

6 Q. Right.

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

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

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

25 So the problem is that when you have a

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

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

12 A. Yes, we are.

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

15 A. I was getting to that.

16 Q. Okay.

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

25 But there's another category that goes beyond

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1 maintenance, which is replacement of systems. In my
2 understanding and belief, replacements of a utility
3 systems, like the replacement of wires, transformers,
4 all of that, is different from the replace- -- or in
5 the case of gas, the replacement -- for example, if you
6 have to dig up the streets to replace the gas line,
7 that's different from maintaining the system. The
8 system requires maintenance and there is provision for
9 those costs in the differential that Mr. Stanton
10 mentioned previously, often called the discount, between
11 the rate that the utility charges the park and the rates
12 that the park is allowed to charge homeowners, and that
13 differential is adequate for maintenance, but there's no
14 way that that differential would be adequate for
15 replacement of the entire system.

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

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

24 Q. Okay.

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

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

7 And I might note that in Table 3-A and 3-B, I
8 took out what might be considered maintenance items in
9 2010 for the utility systems, gas, electric.

10 Q. Would it be fair to say that Tables 3-A and
11 3-B, they don't account in any way for utility expenses
12 for costs?

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

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

22 A. Can you repeat that?

23 Q. Sure.

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

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

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

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

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

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

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

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

5 A. Yes, that's true.

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

11 A. That's right. These are those.

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

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

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

24 THE ARBITRATOR: Thank you.

25 Sir, please step down, subject to recall.

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

3 MR. STANTON: Thank you, your Honor.

4 We call out of order Dr. Ken Baar.

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

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

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

14 Mr. Stanton?

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

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

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

25 THE ARBITRATOR: Let the record show that

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1 Exhibits A through N are admitted into evidence.

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

4 MR. BALLANTINE: Thank you, your Honor.

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

7 MR. STANTON: Yes, your Honor.

8 THE ARBITRATOR: Doctor, please raise your
9 right hand.

10

11

KENNETH K. BAAR,

12

Called as a witness on behalf of the

13

^ Petitioner ^ Respondent,

14

having been sworn, was examined

15

and testified as follows:

16

17

THE ARBITRATOR: Thank you, sir.

18

State and spell your name for the record,

19

please.

20

THE WITNESS: My name is Kenneth K. Baar and

21

the last name is spelled B-a-a-r.

22

THE ARBITRATOR: Mr. Stanton, please proceed.

23

24

DIRECT EXAMINATION

25

BY MR. STANTON:

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1 Q. Dr. Baar, I'm going to first show you a
2 document and just ask you if you can identify this for
3 us. Can you identify that document, Dr. Baar?

4 A. Yes. It's a copy of my resume.

5 Q. And did you prepare this?

6 A. Yes, I did.

7 Q. Does this resume accurately represent your
8 educational, teaching and writing background and
9 history, if you will?

10 A. Yes, it does.

11 Q. So if you could just summarize quickly your
12 education for us.

13 A. Okay, I have a law degree from Hastings
14 College of Law, and I'm also a member of the Bar, and I
15 have a Ph.D. degree in urban planning from UCLA, and I
16 specialized mainly in housing and housing economics in
17 the course of my studies and in writing my dissertation.

18 Q. All right. And I see you've done some
19 teaching, correct?

20 A. Yes, twice I've been a visiting Fulbright
21 professor in East Europe, in the early 1990s in Hungary,
22 and in 2002 to 2003 in Albania, and for one year I was a
23 visiting professor at Columbia University, in New York.

24 Q. And your resume also indicates at pages -- and
25 I apologize because the pages are actually not

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

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

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

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

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

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

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1 A. About 30 jurisdictions.

2 Q. Okay. And have you ever been hired by
3 homeowners or residents?

4 A. Yes. I would say about -- this is a rough
5 estimate -- I'd say about 15 percent of the cases I've
6 worked on is where I have done fair return testimony.

7 Q. This case would be included in one that the
8 homeowners have hired you as an expert?

9 A. Yes.

10 Q. Were you ever hired by a park?

11 A. Yes, in one case, yes, I was.

12 Q. Have any of your articles ever been published?

13 A. Well, pages 8 and 9 is a list of, you know,
14 published articles.

15 Q. Those are all published, correct?

16 A. Yes, in journals, academic and professional
17 journals.

18 Q. Now, on the very last three pages of this
19 document, starting at the bottom of the page that's
20 marked page 12, it indicates that there are some court
21 opinions that apparently quoted you, is that correct?

22 A. Yes. Right. On page 12 is a list of court
23 appellate and state supreme court opinions that, you
24 know, cited my articles, discussions in my articles
25 about fair return issues.

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

3 A. Right, yes.

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

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

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

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

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

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

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

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

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

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

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

25 THE ARBITRATOR: All right. We're going to

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1 use numbers for your side of the fence. So this will be
2 Exhibit 1?

3 MR. BALLANTINE: Yes.

4 (Exhibit No. 1 was marked for
5 identification.)

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

8 MR. BALLANTINE: No objection.

9 THE ARBITRATOR: Thank you.

10 BY MR. STANTON:

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

15 A. Yes, I have.

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

19 A. Yes, yes, there is.

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

22 A. Modestly, I would say that I was one of the
23 initial -- you know, initial leading proponent for the
24 use of that type of theory in fair return analysis, and
25 I think everyone understands, but maybe to clarify a

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1 little, basically this type of standard looks at the net
2 operating income at a base date and presumes that's a
3 fair net operating income, and the fair net operating
4 income in the current year is that base year of that
5 operating income adjusted by either 100 percent of the
6 CPI or half the CPI. It's saying this is a fair
7 starting point and the fair return today is an
8 adjustment of that, and it's different than a return on
9 investment standard which looks at the owner's
10 investment, and basically I've taken the position that
11 that's a circular type of standard, because the park
12 owner determines the -- if you give him the best return
13 on whatever they invest, they basically control the
14 return by controlling the investment.

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

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

24 A. Yes.

25 Q. Would you also describe it as a more objective

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1 fair rate of return determiner as opposed to the more
2 subjective theories that you might be familiar with?

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

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

22 A. Yes.

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

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1 A. Yes.

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

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

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

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

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

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

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

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

6 Q. Why is that?

7 A. Well, because you're looking at the impact, if
8 you -- you know, of the fair return standard over time,
9 and you're looking at the impact of the regulation over
10 time, and so that's -- basically, I mean, I thought it
11 was a little ironic today because to date, you know,
12 2007 was proposed but in other cases, Dr. St. John has
13 testified that one should always use pre-rent
14 regulation, and in other cases where the ordinance says
15 you don't use pre-rent regulation. So I felt -- I
16 didn't feel he was consistent with his prior testimony
17 today about that. And I've been criticized in the past
18 for not using pre-rent control, but I feel in this case
19 there's no reason not to use the pre-rent control. It's
20 available and the ordinance doesn't say you should use a
21 later date.

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

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

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

8 THE WITNESS: Oh, I'm sorry.

9 BY MR. STANTON:

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

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

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

20 A. That's correct.

21 Q. And you recall what that is?

22 A. My understanding is 75 percent of CPI.

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

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1 A. It's common. They range from 50 percent to
2 100 percent CPI. It's an even distribution: About a
3 third of the ordinances are 100 percent CPI, about a
4 third are 60 or 70 or 80 percent --

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

7 A. About 90.

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

10 A. Well, put it this way, I'm aware of the
11 patterns in the ordinances. Obviously, I can't memorize
12 90 ordinances, but I know what's common in them.

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

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

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

22 A. Right. Well, I think I do.

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

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

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

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

12 A. Yes.

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

15 THE ARBITRATOR: Did you wish to mark this?

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

17 THE ARBITRATOR: Yes, sir.

18 (Exhibit No. 2 was marked
19 for identification.)

20 BY MR. STANTON:

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

23 A. Yes, it is.

24 Q. And what is this intended to show?

25 A. Well, basically, I mean, there's been a

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1 running debate for 30 years or whatever on whether 100
2 percent of indexing -- you have to index that upper
3 income by 100 percent of the regular increase in the
4 CPI, and the rationale for 100 percent indexing and the
5 rationale for less, but basically the bottom line is
6 that the courts have said that 100 percent indexing is
7 not constitutionally required and, as I say, this debate
8 has been going on for 30 years.

9 The first courts were upholding less than 100
10 percent, ordinances with less than 100 percent indexing.
11 But then there were two recent decisions -- I say
12 "recent," in 2005, 2007, and they're mentioned on page
13 4, or starting on page 3 of the exhibit, and going to
14 page 7 -- which specifically rejected the argument that
15 100 percent indexing was required and, you know,
16 that's -- so that's the fair return law.

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

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

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

23 A. Well --

24 Q. As opposed to using 100 percent?

25 A. Well, basically what happens is -- it's a

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1 little complicated. Typically, not in all cases, but
2 usually in a mobile home park investment is a leveraged
3 investment, so what that means is that even if your
4 income grows at less than the CPI and operating income,
5 your equity can grow at a faster rate and the simple way
6 to explain that is with the analogy of a house purchase.
7 You buy a house for \$100,000 and let's say you borrow
8 \$80,000, you've put in \$20,000 cash, if the home is only
9 going up by 20 percent, let's say, from \$100,000 to
10 \$120,000, well, the home value is only going up by this
11 amount but, on the other hand, your equity has doubled
12 because you borrowed 80 percent of the purchase price,
13 so basically -- and the other way to look at this is
14 that this a return on a fixed investment, it's not that
15 the investment is growing every year. I mean, if you
16 bought a bond you get the same amount of money every
17 year, the return doesn't grow at all and, arguably, in
18 real estate literature they say, well, real estate is
19 more risky but a mobile home park is certainly not a
20 risky investment. You've got these captive tenants that
21 can't move their homes, these mobile home homes are on
22 the land, so I've never seen a rent risk in a mobile
23 home park. There's a rent risk in start-up, but once
24 the park is full, there's no more rent risk and, plus,
25 in the last five years we have wondered about if any

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1 type of investment is safe, bonds or banks. So there's
2 rationale for 100 percent indexing and there's rationale
3 for less than 100 percent indexing.

4 But I also want to say, to put this in
5 perspective. Dr. St. John said it doesn't really
6 matter, or it's a very small difference for the last
7 three years, but he felt this was an important
8 principle. But even if you go back to his '94 analysis,
9 the difference is only \$13, I think. Between the Table
10 3-B, page 4, the difference between the 75 percent of
11 CPI index and 100 percent indexing is only about \$13.
12 So it's not a major issue in this case. I've seen it be
13 a major issue where this indexing goes back to 1979 or
14 something, and in this case I see it's not a big issue.

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

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

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1 meets the institutional standard.

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

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

18 Q. But the calculation that Dr. St. John has come
19 up with as the numerical total, if you will, in Table
20 3-B on page 4, again, assuming that you agreed with all
21 the content, you would say that \$44.33 is the proper
22 MNOI calculation summary number, if you will, as opposed
23 to \$57.04, which is at the higher indexing?

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

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1 100 percent of CPI. I don't want to say it's a
2 black-and-white issue, but it sounds reasonable.

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

8 A. Yes, I do.

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

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

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

19 THE ARBITRATOR: What tab is it in?

20 MR. STANTON: It's in Tab C.

21 Q. I actually took my Tab C and --

22 A. Yes, yes, I have that document.

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

24 A. Okay.

25 Q. I think it was also Exhibit C to the rent

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1 increase notice, if I recall.

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

5 A. Yes.

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

10 A. Yes.

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

14 A. Yes.

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

18 A. That's correct.

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

21 A. That's my understanding.

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

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1 A. No.

2 Q. Why not?

3 A. This type of expense --

4 THE ARBITRATOR: I'm sorry, that's a compound
5 question. Please rephrase the question.

6 MR. STANTON: Let me break it down.

7 Q. Do you believe that the lease payment increase
8 that has been described in this case should be used in
9 connection with the application and implementation of an
10 MNOI analysis?

11 A. No, I don't.

12 Q. Do you believe that it should be used in
13 connection with a dollar-for-dollar separate charge, if
14 you will, for the amount of the payment increase?

15 A. No, I don't think it should be included in the
16 fair return analysis.

17 Q. Why not?

18 A. Well, I understand that this type of expense
19 is allowed for tax purposes and accounting, but
20 basically what happens is here you have a split
21 ownership of the park in the sense that one person or
22 entity owns the underlying land and another entity has a
23 lease and the right to use the land, and basically this
24 is a payment from one owner of the land with one
25 interest in the land to another party that has another

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

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

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

19 And basically, if you allowed the lease
20 payments as an expense, you'd be allowing the park owner
21 more, a type of rent increase they couldn't even realize
22 they had bought the park instead of -- if the operator
23 had bought the park, they could have passed through the
24 principal or interest, but now the operator is asking to
25 pass through their land lease payments instead. So you

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1 have this result where if you lease the land you can
2 charge a higher rent than if you buy it.

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

8 It's simply a payment from one owner to
9 another, and if the lease were amended tomorrow to
10 provide that the park owner -- the operator had to pay
11 30 percent of the rent to the park landowner instead of
12 20 percent, then a rent increase would be justified
13 under that approach. And then if you could argue about
14 whether 10, 20, 30 percent is fair, the answer would be,
15 well, whatever the market would bear would be fair. If
16 the park owner -- you know, he could pay 50 percent to
17 the landowner, it would just be a circular type of
18 approach.

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

23 A. Well, I'd say either way it should not be
24 included in a fair return analysis, because it's an
25 acquisition cost for an interest that the operator has,

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1 and the fact that it's a percentage just makes it even
2 more circular, because it's like, for example, if the
3 rent goes up, it would justify -- it would increase the
4 land lease payments, which would in turn justify another
5 rent increase. I'd say either way, even if it was a
6 fixed amount, it's an acquisition cost, it's not an
7 operating cost of the park.

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

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

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

21 A. No, it doesn't.

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

24 A. No. In the fair return analysis that I have
25 done, unless the ordinance specifically allows it as an

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1 expense, as far as I'm -- as far as I know, it wouldn't
2 be allowed. I haven't seen this as an allowable expense
3 in cases where, you know, it's not specifically
4 mentioned, and I'll say that's subject to the
5 qualification that I haven't seen every case that's ever
6 happened.

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

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

16 A. Right.

17 (Exhibit No. 3 was marked
18 for identification.)

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

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

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

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

3 A. Yes, I am.

4 Q. What is this?

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

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

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

23 Q. I understand.

24 You heard Dr. St. John testify, I believe, to
25 the effect that ground lease payment scenarios, ground

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1 lease relationships are fairly unique in mobile home
2 park ownership, is that correct?

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

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

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

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

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

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

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

24 Q. Right. So you're saying that that would apply
25 not only to Exhibit C, item 2, the way we see, as a

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1 separate line issue, but if you were going to use it in
2 the MNOI formula you'd have the same conclusion, right?

3 A. Yes.

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

8 A. Yes.

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

12 A. Yes.

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

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

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

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

4 A. Yes.

5 Q. And then do the work within six months?

6 A. Right.

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

9 A. Correct.

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

15 A. Okay, the expenses related to sub-metered
16 systems, whether they're for replacing them, whether
17 they're big, whether they're small, the courts have
18 ruled that those are preempted by the utility
19 regulations. The utility regulations provide that a
20 park owner gets a differential between what they charge
21 and what they pay the utility company, that there is a
22 difference. They can charge the residents more than
23 they pay the utility company, and that differential is
24 designed to cover the costs of maintaining and replacing
25 the system, or whatever, and the Rainbow -- Rainbow

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1 versus Escondido decision made that absolutely clear,
2 and in that case the park owner had spent about \$200,000
3 on gas and electricity expenses and I concluded that,
4 based on the preemption, that those should not be
5 allowed, and the Court upheld that.

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

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

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

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

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

24 And I note that the decision quotes you rather
25 extensively and that comes from the administrative

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1 portion of the lower proceedings, correct?

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

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

6 A. No. It was over 10 years ago.

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

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

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

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

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

23 THE ARBITRATOR: That will be Exhibit No. 4.
24 (Exhibit No. 4 was marked
25 for identification.)

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1 BY MR. STANTON:

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

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

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

14 A. Yes.

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

18 A. Yes.

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

25 A. Well, if you go into the first part, I have

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1 indicated, if you go to line 29, "Increased Land Lease,"
2 I don't think it should be allowed into expenses.

3 Q. Correct.

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

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

21 They could have had other types of increases,
22 cost increases through the years, and basically -- I
23 mean, there's no perfect system in regards to past
24 expenses, but this seems, I don't know, in some ways
25 extreme because basically what is going to happen is if

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1 these expenses are allowed, they are not going to be
2 paid by the residents who are -- many of the residents
3 are the same, but there are some residents who have
4 replaced the residents who were there three years ago
5 and they will be paying this cost increase that, you
6 know, was incurred three years earlier and usually you
7 can't -- there's no clear boundary between cumulative
8 past increases, as opposed to regulatory lag where you
9 couldn't have come in sooner to get the increase.

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

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

18 A. Right, well, basically, yes, or claiming an
19 increase in some other costs that occurred in 2009 or
20 2008.

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

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1 A. That's correct.

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

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

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

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

20 A. Well, I feel the ordinance provides for
21 capital improvements that you can charge before you make
22 the improvement, but the residents can have a hearing on
23 it first. But I haven't seen, you know, where this kind
24 of an expense where you can put -- you know, charge for
25 the anticipated fee, you know, in making a claim about

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1 the property taxes, it should be adjusted because we
2 don't know what the actual fee is going to be.

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

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

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

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

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1 that.

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

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

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

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

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

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

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

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

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

4 A. Yes.

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

10 A. Yes. That's a huge sum. Usually the cases
11 where I have seen fee claims is a case where a park
12 owner makes an application, the City goes over it very
13 carefully, even to determine whether it's complete,
14 there's a lot of correspondence back and forth, they
15 look through the expenses with a microscope -- not
16 always, but they look very carefully, and there's a lot
17 of issues about documentation, sometimes there are
18 issues about if the base rent is fair. Generally, you
19 know, a lot of work goes in and typically -- you know,
20 I'm not counting cases where there's a writ filed, but
21 typically in those cases, the fees are in the \$20,000,
22 \$30,000, \$40,000 range, and here's a case where I see
23 that, to me, the rent increase application process was
24 fairly simple; the County, as far as I know, didn't do
25 much review, basically. You know, it's -- the hearing

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1 was before an independent party, it wasn't before a rent
2 commission where -- and there was not a lot of back and
3 forth, and so I see less work and a much, much higher
4 fee.

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

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

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

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

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

21 THE ARBITRATOR: Identified as "Legal
22 Expenses"?

23 MR. STANTON: Yes.

24 (Exhibit No. 5 was marked
25 for identification.)

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1 BY MR. STANTON:

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

4 A. Yes, I did.

5 Q. And what did you base the preparation upon?

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

11 Q. I notice the top one, which appears to be
12 Carson Gardens. Carson 2006 is the most expensive of
13 the lot. Can you explain any reason why that was
14 \$172,000?

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

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

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

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

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

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

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

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

19 A. Yes.

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

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

24 Q. I believe at the very bottom line item, Valley
25 Breeze, Yucaipa, refers to the same park, correct, and

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1 this talks about the resubmission after a writ was
2 granted?

3 A. Okay, yes, okay.

4 Q. So that's the same park which is --

5 A. It increased -- I'm sorry, I made a mistake
6 here. First it was \$57,000 and then went up to \$69,000.

7 Q. The other four items, Grandview, Ponderosa and
8 Villa Vista on page 2, and Yucaipa Village on page 2 is
9 where there was just one administrative hearing,
10 correct?

11 A. Yes.

12 Q. And the range on those was \$24,000, low, to
13 \$48,000, high, correct?

14 A. Yes.

15 Q. So are you indicating, based upon your
16 experience as represented somewhat by this Exhibit 5,
17 that you believe \$125,000 is excessive to provide the
18 park owner prospectively in this case?

19 A. Well, let me -- prospectively or
20 retrospective, that -- assuming that the end to this
21 case is the administrative hearing, or the hearing, it
22 would be way out of line with what the typical costs
23 are, legal costs and application costs, also includes
24 the expert cost that park owners incur when they make
25 these kind of applications.

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1 Q. Okay, let's talk about the amortization rate.
2 You heard testimony from Dr. St. John that amortization
3 rate was used for the temporary increase items and I
4 think it was consistent, 7 percent interest rate over a
5 nine-year period.

6 A. No, it was 9 percent interest rate over a
7 seven-year period.

8 Q. Oh, I'm sorry, you're correct.

9 So you obviously recall that better than I, or
10 at least better than I wrote it down.

11 Do you believe that this is an acceptable
12 amortization to use for any of the temporary increase
13 items, assuming that those items are correct for the
14 moment, that any of them might have been correct? We've
15 talked about some might not be, but assuming they are
16 correct, do you believe that's a proper amortization to
17 use?

18 A. No. Unfortunately, there's not systematic
19 data on what, you know, periods are used. I know what
20 some jurisdictions use, but they seem low.

21 You know, I have indicated that the electrical
22 shouldn't be counted because it's preempted by state
23 law, but an electrical system that's completely
24 replaced, or virtually replaced shouldn't last only
25 seven years. I'm not an electrical contractor, but

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1 that's just my experience, you know, in listening to
2 experts in these cases.

3 And the road thing is, the amortization for
4 roads varies. Here the bids was for \$400,000, which is
5 substantial, so I imagine that's a major re-doing of the
6 roads in the park and you wouldn't -- I don't think that
7 would only, in my experience, you know, with these
8 cases, the amortization period for that kind of expense
9 has been longer, but I'm saying I'm subject to that
10 qualification; I'm not a road contractor or road expert,
11 but those seem short.

12 As far as the interest rate, typically I've
13 seen 7 percent instead of 9 percent. If somebody goes
14 out and buys a park today, that's the capitalization
15 rate they could expect. That's the rate of return you
16 could get on a real estate investment, which is lower
17 than in the past, but that's because all other types of
18 investments often paid close to zero.

19 Also, interest rates are low, money is very
20 cheap to borrow, so 7 percent. I'd also point out,
21 whether 7 percent is used or whether 9 percent is used
22 has very little difference on the outcome, very little.
23 Use a 15-year amortization instead of seven years, I
24 think the annual costs would be about half, so that does
25 have some impact, if the amortization period is

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1 substantially increased.

2 Q. The annual cost that the residents would pay?

3 A. Yes, because they would pay for a longer
4 period but it would be have halved, and it would drop
5 off, of course, sooner if it were paid off over seven
6 years.

7 Q. I'll have you look at two more documents that
8 I believe you have. The first one is a -- well, it's
9 entitled at the very top, in small print, "Chapter
10 540-2, Mobile Home Space Rent and Stabilization," and
11 it's a four-page document.

12 THE ARBITRATOR: Do you wish to mark this as
13 the next exhibit?

14 MR. STANTON: Yes, that would be Exhibit 6,
15 your Honor.

16 (Exhibit No. 6 was marked
17 for identification.)

18 BY MR. STANTON:

19 Q. If I ask you, Dr. Baar, do you know what this
20 document is or where it comes from?

21 A. This is from the Contra Costa County
22 ordinance. Many ordinances don't have the
23 capitalization schedule in them. If I had more time I
24 could possibly have found some more, but that one shows,
25 if you look over at the second page, it shows the land

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1 improvement, such as roads, 20 years. But then on the
2 other hand, for paving it says reslurry, four years, and
3 resurfacing, eight years. And so I guess the question
4 is what the park owners are doing. Is it closer to a
5 new paving or is it closer to a resurfacing? It's
6 clearly not, from my understand, a reslurrying.

7 Q. Just to make sure I understand the
8 significance of this document, you're saying that what
9 we're looking at is actually contained within the
10 ordinance language itself in Contra Costa County?

11 A. Yes.

12 Q. And is this a schedule that that county
13 actually uses, then, for mobile home park capital
14 improvement analysis?

15 A. Let me say it's in their ordinance. If they
16 don't use it, they are not following their ordinance.

17 Q. And then finally I'd like to mark as Exhibit
18 7, and I provided the hearing officer with this
19 document, a two-page document which has page numbers at
20 the bottom, 27 and 28. There's no title at the top. It
21 begins with the words ". . . shall divide the total cost
22 of the improvement," and appears to be a couple of pages
23 out of a manual or a book of some sort.

24 (Exhibit No. 7 was marked
25 for identification.)

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1 BY MR. STANTON:

2 Q. Can you describe what this document is.

3 A. Yes. These are from the City of Yucaipa.
4 Yucaipa is interesting because they have, I think, 30
5 mobile home parks, so they have a lot of mobile home
6 park rent stabilization fair return cases and capital
7 improvement applications, and this is from their
8 regulations.

9 And this provides, on the second page, the
10 amortization period for paving is 15 years. So these
11 are just examples. And as I say, I'm not a roads
12 expert, but you know, seven years for what seems like,
13 you know, a real overhaul of the road system is a short
14 period.

15 Q. So to summarize your testimony on this point,
16 what you believe the proper interest rate should be that
17 should be used for any of the temporary increase
18 categories, does that appear on Exhibit C?

19 A. I'd say there's no single proper interest
20 rate. I'd say the most reasonable would be 7 percent
21 because that's the return if somebody goes out and buys
22 a mobile home park today, that's what they expect.

23 Q. And as to time, do you have an opinion, based
24 upon what we've just looked at, as to how long it should
25 be amortized or would that opinion have to be based upon

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1 knowing what the improvements are?

2 A. Well, I guess what I would like to see in this
3 case was, you know, some evidence from the park owner,
4 the applicant, some opinion about what the useful life
5 of this is or also maybe an opinion with the persons
6 that made the bid about what the useful life was, so I
7 don't want to say X number of years is the right number
8 of years.

9 Q. Well, when we see item No. 3, capital
10 improvements, third line item, "Infrastructure,
11 \$320,000," can you tell from this document what
12 infrastructure we're talking about?

13 A. No. My understanding is that this is what the
14 lender required the park owner to place into escrow.
15 It's not connected to a particular capital improvement,
16 as far as I know.

17 Q. I guess what I'm asking is, wouldn't you need
18 to know what improvement it's connected to in order to
19 really assess the time period over which amortization
20 should be measured?

21 A. Right. Well, let me say this. The fact that
22 the lender made the park owner put \$320,000 in escrow
23 for future capital improvements is not the basis for
24 rent increase; the basis for the rent increase is a
25 specific capital improvement that's identified, a

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1 reasonable estimate as to the life before it goes
2 forward, and that's just not here, so I'm sort of
3 testifying a little bit in the dark. I just know
4 there's some money here that the lender required.

5 The fact that the lender required the park
6 owner to put the money in escrow is not a basis for
7 passing through. It's really a reserve amount until
8 it's spent or it's expenditures identified in some
9 detail.

10 Q. Let me try to ask sort of a wrap-up question
11 here and going back to the MNOI calculation that's been
12 presented, do you have any other comments with respect
13 to specifically the tables that have been marked as part
14 of Exhibit D and labeled Tables 3-A and 3-B? Do you
15 have any other comments?

16 A. You're going to Exhibit D now?

17 Q. Yes. The specific MNOI analysis that
18 Dr. St. John has presented that is marked and tabbed as
19 Exhibit D in the binder that we received today.

20 A. Well, the comment I'd make is if you look on
21 exhibit, you know, Table 3-B, page 4, and you go to
22 page -- line 156, it says "Net Justified Increase,
23 \$79,732," and then you go back to page 2, line 87, and
24 you see that the lease payments increased from \$39,338
25 to \$113,340, which is about \$74,000, and the net

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1 justified rent increase is \$79,000, so basically, you
2 know, if the claim weren't made for the lease payments,
3 that would basically have eliminated the net justified
4 rent increase of \$74,000.

5 Q. So the resulting MNOI number would, obviously,
6 be a lot less?

7 A. Right. The justification for this rent
8 increase under the MNOI standard is driven by the lease
9 payments.

10 Q. Do you have any other comments to Tables 3-A
11 or 3-B as they were presented today by Dr. St. John?

12 A. Okay, the other one I have which I remember
13 was about -- maybe the questions would bring out the
14 answer. The subscriptions went from a few hundred
15 dollars to about \$12,000. You'd have to find the line
16 that's on.

17 Q. I think that's line item 84 --

18 A. Yes.

19 Q. -- on page 2 of the tables.

20 A. Yes. That should be clarified, because I've
21 seen in a number of cases where the dues to the WMA, the
22 Western Mobile Homeowners Association, which is really
23 an advocacy group for the park owners, and I'm not
24 criticizing the park owners paying those dues, but they
25 wouldn't be an allowable expense, operating expense that

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1 can be passed through to the residents.

2 Q. In other words, you're saying it's advocacy
3 which benefits only the park owner as opposed to the
4 residents and it's elective and not mandatory?

5 A. I wouldn't say that it's elective and not
6 mandatory, is not the issue, because you can say that
7 about a lot of things, but it's not an operating cost to
8 the park, it's a cost basically for advocacy, you know,
9 to eliminate rent regulations, and there might be other
10 uses for the money, but basically it's not for operating
11 the park. But that's a subject that we haven't heard --
12 the park owner might have a different explanation of
13 what those costs are for.

14 Q. Sure. Would you just want know more about
15 that?

16 A. Right.

17 MR. STANTON: I may not have any more
18 questions, your Honor. Can we take our break now and
19 determine that?

20 THE ARBITRATOR: Yes. Let's take a 15-minute
21 break and we'll be back here at 25 after the hour.

22 (A brief recess was taken.)

23 THE ARBITRATOR: Do you have additional
24 questions for your witness?

25 MR. STANTON: Only a couple, your Honor.

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1 THE ARBITRATOR: Proceed.

2 BY MR. STANTON:

3 Q. Dr. Baar, did you want to clarify anything
4 about the base year testimony that you gave?

5 A. Well, I wanted to make one point because
6 otherwise I'll hear about in the next case. I have
7 recommended that the base year be back to 1994 because
8 it's the first year that expense data is available, and
9 I understand that's when the ordinance was adopted, or
10 just before, and I wouldn't have recommended that it be
11 the base year in a prior rate-of-return decision in this
12 case. I want to make that clear.

13 Q. If there had been a prior fair-return hearing,
14 you would have used that as the base year?

15 A. No, I would have recommended that that be used
16 as the base year.

17 Q. Is there any case where you've ever concluded
18 from the work you've done that a substantial rent
19 increase ended up being justified?

20 A. Yes. The cases I've worked on are wide
21 ranging, and there's a number of cases where I've
22 determined that \$85 or a \$100 increase is justified, and
23 there are others where I've concluded no increase was
24 justified, and many in the middle -- you know, other
25 ranges.

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1 Q. Is this one of those cases where a large rent
2 increase is justified?

3 A. No. Basically -- well, first of all, the
4 first part of the underlying analysis is, as I
5 indicated, if you take out the lease payments, which I
6 don't think are justified as the costs of a fair return
7 application, the park owner would be entitled to a very
8 minimal increase, and the problem with the temporary
9 increases is that there's money in escrow but there
10 really hadn't been anything that's been identified as a
11 basis for a cost increase, and the claim for legal
12 expenses for the application, I think, is completely out
13 of line of what would be typical for a fair return
14 application. So I do not have precise numbers, nor have
15 I put numbers into this, but I feel like if any rent
16 increase is justified, it would be very small.

17 MR. STANTON: Thank you.

18 No further questions.

19 THE ARBITRATOR: Mr. Ballantine, any
20 cross-examination?

21 MR. STANTON: Yes, your Honor.

22 THE ARBITRATOR: Please proceed.

23

24 CROSS-EXAMINATION

25 BY MR. BALLANTINE:

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1 Q. Is Mr. Baar or Dr. Baar?

2 A. Well, "Dr. Baar" sounds stuffy, but I do have
3 a Ph.D.

4 Q. All right. Dr. Baar, let me pick up on some
5 of your last questions -- or your last answers to the
6 questions regarding the rent increase.

7 As an economist, have you performed an
8 assessment of exactly what the justified rent increase
9 would be in this case?

10 A. No. I haven't made a particular calculation.
11 And when you say "as an economist," I have an Ph.D. in
12 urban planning and extensive expertise in fair return
13 law, but I don't have a Ph.D. in economics.

14 Q. You're not trained as an economist?

15 A. No.

16 Q. You're not an economist, then?

17 A. No, I'm not an economist, I'm an expert in
18 housing economics and fair return.

19 Q. But your Ph.D. is in housing, not economics?

20 A. That's correct.

21 Q. So essentially your knowledge of the fair
22 return is essentially on the legal side?

23 A. No, I'd say it's on the real estate side, too.

24 Q. It's on the real estate side. You have
25 training in economics?

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1 A. Well, in the course of my preparing my Ph.D. I
2 did a lot of study of housing economics, and when I
3 taught housing, a lot of it had to do with housing
4 economics. I mean, that's the best --

5 Q. Do you have training specifically in economics
6 to the degree of analysis -- specific analysis using
7 economic theories and mathematics?

8 A. No. My background in economics has do with
9 fair return, has to do with fair return in real estate
10 economics.

11 Q. But in whatever sub-field it is, my question,
12 sir, is do you have a background and training in
13 economics in the sense of using numbers and formula and
14 mathematics to derive results?

15 A. Well, yeah. I mean in real estate economics
16 you do all of that.

17 Q. What is your training?

18 A. Well, okay, let me say this. When you say my
19 training, you know, in the course of my work I spent 30
20 years doing fair-return analyses, and in the course of
21 preparing my dissertation was a lot of -- there was a
22 lot of the -- how, you know -- how economics related to
23 the real estate, but I didn't go to economics school.

24 Q. Did you take any classes in economics?

25 A. Rarely.

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1 Q. Okay. So have you performed an MNOI analysis
2 for Nomad Village Mobile Home Park?

3 A. What I did was I prepared comments or analyses
4 of specific parts of this application, but I didn't come
5 to a bottom number.

6 Q. So you have not prepared an MNOI analysis for
7 Nomad Village Mobile Home Park, correct?

8 A. No, I haven't done that, you're right. I
9 commented on specific parts of the costs claimed in this
10 application.

11 Q. We're going to talk about the comments you
12 made, but I want to be sure that we're clear. As you're
13 sitting here today, you have not come with an analysis
14 that you have prepared that you would purport to be an
15 MNOI analysis?

16 A. That's correct.

17 Q. And secondly, as I understand your testimony,
18 you haven't come today with a number in which you would
19 say that this is the number, an appropriate number for
20 rent increase that's warranted under the law, correct?

21 A. Right.

22 Q. So you don't have a number that we have to
23 work with that you would say this number is okay.

24 A. Right, but I would say -- no, you're right.
25 My analysis has been more certain parts of your

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1 number -- numbers should be changed.

2 Q. Like I said, we'll get into those pieces,
3 believe me. But I want to be sure that as you're
4 sitting here now, you don't sit here and say under the
5 facts as you've assessed them and under the law that you
6 claim to be an expert in fair-return analysis, that
7 there's a number that constitutes a fair return for this
8 particular park?

9 A. That's correct.

10 Q. Well, let's talk about some of the
11 sub-sections.

12 Now, you talked about fair-return analysis,
13 and you talked a little bit about using a base year
14 value, and you said one of the things is with the base
15 year value, or the base year, is to presume that the
16 park owner was getting a fair return in that base year,
17 is that correct?

18 A. That's correct.

19 Q. And do you know that Nomad Village Mobile Home
20 Park, Nomad Village, Inc., was getting a fair return in
21 1994?

22 A. Well, let me say this presumption and my
23 understanding is that was about when the ordinance was
24 adopted, so it would have been close to the rent that
25 the park owner, you know, picked or selected. You know,

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1 either regulation had barely impacted it or had not
2 impacted it, and, secondly, there was no evidence that
3 it wasn't a fair base rent.

4 Q. All right. So you said two things I think I
5 want to break down. Now, we're talking about the 1994
6 analysis, and as I understand it's your opinion that you
7 have expressed that this arbitrator should use '94 as
8 the base year?

9 A. Right.

10 Q. All right. Under MNOI analysis?

11 A. That's correct.

12 Q. And I think you have two reasons from that.
13 The first reason is that 1994 is about the year that the
14 rent control ordinance came in effect, and so you're
15 presuming that the park owner was getting a fair return
16 because there were market forces that were in play that
17 would have led to the numbers that we would see in their
18 financials.

19 A. Right.

20 Q. Got it. And the second one was you haven't
21 seen any evidence that the park owner wasn't getting a
22 fair return?

23 A. Right. And other factor is that it's the
24 earliest year that's available, to my understanding.

25 Q. All right, that's the third thing.

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1 Well, let's go back to the first factor. I
2 guess what you are essentially saying is that the idea
3 would be that you go as close as you can to the time
4 that the rent control ordinance went into effect because
5 you have a park owner that's allowed to make their rents
6 whatever -- essentially, whatever the market rate is and
7 their expenses should be reflective of market expenses?

8 A. Yes, as close to the market as is available.

9 Q. Okay. And if you go further away, if you go
10 into the rent control, a period of a time in which rent
11 control has taken place, then we don't necessarily know
12 if that's the case, correct?

13 A. You say "that's the case." You mean --

14 Q. What you just said, that the income and
15 expenses are market based, well, particularly the
16 income, that the income is market based?

17 A. No, as you go through time the income is more
18 based on ordinance. The older the ordinance is and the
19 more you're into it, the rent is set by the ordinance
20 rather than the park owner.

21 Q. And wouldn't it be fair to say in those types
22 of cases, the further away you get from the start of the
23 ordinance, the more suspect the more -- or let's just
24 say, the less value is being market driven with that
25 year for being a base year for income?

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1 A. Right. I'd say it's preferable, but I'd also
2 say if you have -- you know, if you had a fair-return
3 application, or if you don't have better evidence, that
4 it's reasonable to use it.

5 Q. All right. Now, have you looked at the
6 Santa Barbara County Rent Control Ordinance?

7 A. Yes.

8 Q. When did you first become aware of it?

9 A. Well, I don't know when I first became aware
10 of it.

11 Q. Let me ask you this. When did you first
12 engage in any study or analysis of the rent control
13 ordinance?

14 A. Recent. Well, I say recently.

15 Q. For the purposes of this case?

16 A. Yes. I mean, I might have looked at it
17 before . . .

18 Q. You don't have any recollection of doing that?

19 A. No, not specifically.

20 Q. And what exactly did you do to review the
21 ordinance?

22 A. Well, I basically focused on the increases in
23 the maximum rent schedule section. And because that's
24 what I basically -- I basically focused -- that's what I
25 basically focused on.

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1 Q. When you were studying the ordinance, did you
2 note that in fact the ordinance was enacted in 1994 but
3 was enacted in 1979?

4 A. No. No, I didn't.

5 Q. You didn't know that?

6 A. Okay.

7 Q. You didn't know, for example, 11A-3,
8 Exemptions, talking about the chapter applying as of
9 November 21, 1979?

10 A. Right. Okay. I see what you're saying.

11 Q. And you didn't note that -- all right. So you
12 weren't aware that it's been around since 1979?

13 A. No.

14 Q. So you would have to concede, then, that 1994,
15 in fact, is almost 20 years after the rent control
16 ordinance was first enacted?

17 A. Yeah, 15 years, yes.

18 Q. All right, 15 years. And so based on your
19 testimony, you would concede that there's some question
20 as to whether or not the 1994 numbers were truly
21 reflecting market conditions?

22 A. Right.

23 Q. So that lessens its value as a base year?

24 A. Yes, it's not as good. I still think it's the
25 best base year.

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1 Q. Sir, there's not a lot of difference between
2 1994 and 2007, is there?

3 A. Well, I think there's 13 years.

4 Q. Well, what about 2007 makes it less valuable?

5 A. Well, I think, you know, basically you're just
6 looking at the impact over a three-year period,
7 comparing two points that are only three years part as
8 opposed to comparing -- if you go back to 1994, you're
9 comparing two points that are 18 years apart, and you're
10 looking at how the rent increases compared with what
11 would be a fair return. You're looking at the income at
12 two points 18 years apart and so you're looking at a
13 long-term impact of the regulation.

14 Q. Well, you're also looking at a point --
15 neither one of those are close to the time in which the
16 ordinance was first enacted, correct?

17 A. That's correct.

18 Q. So to that degree, neither one of them is
19 going to be particularly valuable in telling us that
20 this gives us idea for the base year of what market
21 conditions were like, "market" meaning unregulated rents
22 for mobile home spaces.

23 A. Well, right, but I think that, you know,
24 there's a big difference between looking at an impact of
25 the ordinance over 18 years and looking at it over three

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1 years, and what happened is that three-year period, you
2 have property tax increase, but on the other hand,
3 before the sale for 15 years, you know, 13 years,
4 property taxes were going up 2 percent a year, I
5 imagine.

6 Q. You imagine. But you don't know because you
7 didn't study any of the financials for this year, did
8 you?

9 A. Right. So you're looking at long-term impact,
10 and the other you're looking at very short-term impact.
11 Even if it's true that they were well into the rent
12 control period, you're looking -- I think, basically, in
13 these cases, you know, they have tried to use the
14 earliest period possible. That's the theory, unless
15 there's been a prior application.

16 Q. Was there a prior application?

17 A. Not to my knowledge.

18 Q. And other than that, other than just you like
19 a long span of time do you have any other reasons for
20 favoring 1994?

21 A. No.

22 Q. Can you identify anything that's happened
23 between 1994 and 2007 that would indicate -- other than
24 the passage of time, that would indicated one year is
25 preferable over the other?

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1 A. No, that's the factor, the fact that one is
2 measuring long-term impact and one is measuring
3 short-term impact.

4 Q. But you can't identify anything that's
5 happened over that period of time, can you, that would
6 somehow impact the MNOI analysis or make one year more
7 valuable than the other, is that correct?

8 A. No, not apart from that.

9 Q. Okay. Now let's talk about the indexing
10 amount. You've also said that we -- you think that we
11 should use the 75 percent of CPI indexing and not 100
12 percent indexing, but your position is that it's not
13 black and white and there's no specific rule in the
14 ordinance or provision in the ordinance that governs
15 that, is that correct?

16 A. Right. Except I would say one thing. The
17 ordinance -- there is a provision that the adjustment --
18 that half the allowable annual increase is used as the
19 profit adjustment factor, the return on investment. If
20 you go to section 11A-5, and if you go to section
21 (i)(1), it says: "First grant one half of the automatic
22 increase to management as adjusted reasonable return on
23 investment." And that seems to indicate that they're
24 saying, you know, adjusting the NOI by one half of the
25 automatic increase.

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1 Q. You're saying it suggested that but it doesn't
2 specifically say that?

3 A. It doesn't use that language, but it's the
4 type -- it's an adjustment -- it's a profit adjustment
5 as opposed to an expense, because section I-2 is the
6 expense adjustment. Then, you know, there are also
7 additional expense adjustments. Section I-1 is the
8 profit adjustment, and that's something less than CPI.

9 Q. So as I understand your testimony now, you're
10 essentially saying that there's no explicit requirement
11 that the indexing from the base year be something less
12 than the CPI index, but you think that the provision
13 that you just mentioned suggests that that may be the
14 better approach?

15 A. Right.

16 Q. All right. Now, you've also provided, I
17 think, a justification for why you think it's okay not
18 to let park owners, in calculating their fair return,
19 not to go at 100 percent of CPI, even though you have
20 CPI going along and, as I understand it, your position
21 is because real estate is leveraged and the equity is
22 growing. So the equity is kind of compensating for
23 that, the --

24 A. In the standard case, yes.

25 Q. Okay. Well, how about this case?

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1 A. This case, I don't know. But the regulation
2 deals with the standard case and you don't want a system
3 where you tie the rent increases to the particular
4 leveraging of the particular owner. I mean there's
5 strong rationale for not doing that.

6 Q. Your strong rationale, as I understand it, is
7 because that real estate is leveraged and real estate
8 equity grows, correct?

9 A. Yes, that's one rationale. It can grow faster
10 than the increase in the rents.

11 Q. Okay, I understood that. Is there anything
12 else, is there any other basis by which you justify less
13 than 100 percent indexing?

14 A. Well, one thing is, the courts have said --
15 one thing is you have a kind of thing that -- you know,
16 when you're looking at fair return, even though it
17 speaks in economic terms, the courts have also said it's
18 a legal concept.

19 If the courts came out tomorrow and said 100
20 percent indexing is constitutionally required, I
21 wouldn't be here testifying that less than 100 percent
22 indexing is okay. But the courts have done the
23 opposite. In the Court of Appeal opinions they have
24 said less than 100 percent indexing is constitutional,
25 you know, on the some of the grounds that I've

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1 described, and they have specifically upheld 40 and 50
2 percent indexing.

3 Q. Let's make sure we have apples and apples. In
4 those cases we are talking about the automatic
5 increases, correct?

6 A. No, talking with the NOI standard.

7 Q. The NOI standard for the indexing. But the
8 rationale that you said and told us about, the reason
9 why it's okay for the park owner, that you have said --
10 because you've said it's ambiguous in this case but it's
11 suggested that, under the ordinance, that we ought to do
12 75 percent -- suggestion -- so I want to go into
13 rationale as to where that came from, and your rationale
14 is that the equity -- basically, the equity growth
15 compensates the park owner for that?

16 A. In the industry.

17 Q. Do you have any other rationale?

18 A. Well, another rationale is it's, you know,
19 it's not a growing investment, it's a return on a fixed,
20 risk-free investment in land. It's a fixed investment.

21 Q. Anything else?

22 A. No. Those -- I'd say --

23 Q. Those are the two bases?

24 A. Yes.

25 Q. In this particular case the park operator

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1 doesn't own the property, my client doesn't own the
2 property, does he?

3 A. No, he --

4 Q. He's not going -- he or it -- it's actually an
5 entity, it -- it's not going to realize any equity gain,
6 it's not going to have anything to sell when --

7 A. Right, but somebody else does own the
8 property --

9 THE ARBITRATOR: It's question and answer,
10 please.

11 MR. BALLANTINE: I'm sorry, your Honor.

12 Q. Go ahead, Doctor.

13 A. But there is somebody else. There's a split
14 ownership in this property, in a sense. The park -- the
15 applicant has a lease interest, somebody else owns the
16 land, and they have a right to a return on that land.
17 And there are dual owners of this property, and the
18 return is growing and the value of the property is
19 growing.

20 Q. But that's not accruing to the benefit of my
21 client, is it?

22 A. Well, your client is entitled to a growth in
23 net operating income, so I'd say yes.

24 Q. But your whole rationale for saying that the
25 only growth he gets is 75 percent of CPI is the idea

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1 that the equity growth is going to compensate him, and
2 I'm simply saying, that equity growth compensation is
3 not going to happen for my client, correct?

4 A. No, it's going to happen for the land owner.

5 Q. Right, and that's not my client.

6 Now, your other issue was that return on a
7 fixed investment, and you're saying a mobile home park
8 is not a risky investment?

9 A. Yes.

10 Q. But essentially it has some risk, doesn't it?
11 If my client is not able to get a rent increase and is
12 operating at a loss, that is some risk, isn't it?

13 A. Well, let me say, nothing has no risk. I'd
14 say that there's no -- you know, there could be
15 hurricanes, floods, earthquakes, all that stuff. And
16 I'll clarify. There's virtually -- I'm not saying it's
17 100 percent, but there's virtually no rent risk. Once a
18 park is full, the mobile homes are there, if the rent
19 goes up and it's really high, the value of the mobile
20 homes goes down and acts a cushion. So basically, you
21 know, the park owner has security that they can always
22 get the rents for the spaces. They have the mobile
23 homes as security on the spaces.

24 Q. Well, but they don't hold security interest in
25 the mobile homes, correct?

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1 A. Well, if the resident doesn't pay the rent
2 they're going to lose the mobile home. And the park
3 owner, my understanding, can make some kind of -- the
4 mobile home is not, as practical matter, moveable so you
5 have got this buffer in there, and the whole literature
6 I've seen and reports over and over is that the vacancy
7 rates, unless a park owner raises the rents through the
8 moon, the vacancy rates are about 1 percent.

9 Q. But, sir, isn't there a further risk factor
10 that if operating costs rise sufficiently, the park
11 owner can't recover those, they're operating at a loss,
12 that's a risk, isn't it?

13 A. Yes. It's not zero risk, they have a right
14 under the ordinance to a growing net operating income,
15 which means a right to cover their operating costs
16 increases.

17 Q. We'll see about that, I guess, won't we.

18 Let me go, then, to some operating costs. The
19 ground lease increase, you've challenged the recovery
20 for any amount of increase in the ground lease?

21 A. That's right.

22 Q. And as I recall, your Exhibit 3 that you
23 provided -- and this is from your collection -- and
24 these are, as I understand, quickly glancing at these
25 and your testimony, Exhibit 3 is various ordinances that