Compliance with State Law and the Santa Barbara Mobilehome Rent Control Ordinance

The ruling authority for mobilehome rent control arbitration is Chapter 11A, which specifically requires that all rent increases **comply with state law**. An arbitrator's findings are not adequate in the manner required by law if the raw evidence in the paper record upon which he bases his opinion and award does not comply with the ordinance's provisions and state law, including the California Constitution.

Award #4: All granted temporary increases are to be amortized at 9 percent for seven (7) years.

The court affirmed this award on page 30 of its mandate, citing substantial evidence to support it by virtue of Exhibit C and Dr. St. John's testimony that these numbers are the result of his professional judgment, completely disregarding Dr. St. John's testimony questioning the propriety of 9 percent, the interest rate that management instructed him to use:

> "I can't say that there's anything particularly appropriate about 9 percent and seven years for item 4, but it seems like an amount that the park owner is willing to agree to and so I'm approaching it that way."
> (Sept. 19, page 75, lines 6–10)

> "As far as the interest rate, typically I've seen 7 percent instead of 9 percent. If somebody goes out and buys a park today, that's the capitalization rate they could expect. That's the rate of return you could get on a real estate investment, which is lower than in the past, but that's because all other types of investments often paid close to zero."
> (Sept. 19, page 101, lines 12–18)

Expert opinion and professional judgment must comply with the provisions of §11A-6, which limits reasonable financing costs to capital expenses and capital improvements, and Article 15 of the California Constitution titled Usury, which specifies the maximum interest rate of 7% for capital improvements to real property.

As defined in §11A-2, a capital expense is “a repair or replacement of existing facilities or improvements which has an expected life of more than one year,” and a capital improvement is “any addition or betterment made to a mobilehome park which consists of more than mere repairs or replacement of existing facilities or improvements and which has a useful life of five or more years.”

Mr. Waterhouse admitted that no capital improvements or capital expenses were definite and certain. In testifying about the $320,000 escrow account attached to his mortgage loan from Berkadia, he said: “…we don’t know exactly where it’s going to end up at this point in time, what work we’re actually going to perform.” (Sept. 20, page 166, lines 20–22)

Expenses correctly categorized as costs for capital items must be directly affixed to specific capital items. Since no capital improvements or capital expenses were definite and certain, the costs presented by management in its exhibits are operating expenses, ordinarily paid from operating income, that do not qualify as capital items, or correctly categorized costs of a capital improvement or capital expense, and have no useful life beyond the immediate. According to Dr. St. John:

> “The ordinance…It doesn’t go into as much detail as some ordinances. So when we sought out these items, particularly 4, 5 and 6, I wasn’t 100 percent certain how they should be handled. They could have been simply addressed as cash items and put in the MNOI in the normal way, but that just didn’t seem right, so some of these amounts were related to prior years, some of the amounts related to future years, some related to this year, and all of those amounts were taken out, summed and treated by analogy to the way the capital improvements are treated. They’re not capital improvements, that’s true…” (Sept. 19, page 84, lines 3–15)

None of the awards meet the ordinance’s criteria for §11A-6. §11A-5 provides for the treatment of operating expenses, does not include reasonable financing costs and does not specifically provide, or even imply approval, for interest, as stated by Mr. Ballantine (Sept. 19, page 19, lines 24–25 and page 20, lines 1–10). Allowing management to circumvent §11A-6 by analogizing and reclassifying operating expenses as capital items violates the construction and intent of Chapter 11A,

including §11A-4(b): “The arbitrator shall set and adjust rents in accordance with the standards set out in this chapter.”

Amortizing extraordinary operating expenses over seven years at zero percent interest under §11A-5 may be within the arbitrator’s discretion, which was not exercised. Awarding interest above and beyond the limits set by the ordinance and the California Constitution fails to proceed in the manner required by law.

Notwithstanding the findings of the court and the board that “the arbitrator did not abuse his discretion,” award #4 is voided by the provisions of the ordinance and the California Constitution, as well as by Neutral Arbitrators Ethics Standards 1(c) intended to guide arbitrators’ conduct to conform to all applicable law.

Award #5: Homeowners are to pay the $320,000. If none of these monies are spent on eligible items within six months of the date of this award, the residual amounts are to be returned to the Homeowners.

The court remanded $62,145.55, “assertedly for capital improvements and capital expenses eligible to be passed through to homeowners” (page 26), for reconsideration. The court did not rule that the documents evidenced eligible capital improvements and capital expenses, but rather mandated that the amount be validated by proceeding in the manner required by law.

When asked by Mr. Ballantine during testimony, Mr. Garcia said that all expenses in Exhibits J and K totaling $62,145.55 relate to Nomad Village capital items (Sept. 20, page 101, lines 9–14).

These exhibits show no evidence of expenses inseparably associated with or affixed to eligible capital improvements. Since no capital improvements were definite and certain as of the date of hearing or completed within six months of approval of this award, these expenses do not qualify as correctly categorized costs of one or more capital improvements, as well. These are obviously operating expenses that do not qualify, as addressed in award #4.

Award #5 violates the express provisions of the ordinance regarding capital improvements and capital expenses, as well as §11A-4(b): “The arbitrator shall set and adjust rents in accordance with the standards set out in this chapter.”

Award #6: The Homeowners are to pay $25,000 for professional fees associated with the capital improvements.

The court ruled on pages 27 and 28 that “…where professional fees may be correctly categorized as a cost of either a capital improvement or capital expense, such fees may be passed on. …However, the arbitrator does not identify which professional fees are awarded and which professional fees are not except by the total amount awarded. …the arbitrator’s finding here may have been influenced by its erroneous determination as to the $320,000 escrow funds. …Remand is appropriate to this award as well.”

The board then remanded #6 for abuse of discretion, adequate findings about the nature of these fees and, as specified in the arbitrator’s December 2011 award, that they be associated with capital improvements.

Exhibits K and Q show no evidence that the vaguely described attorney fees are correctly categorized as costs of capital improvements. As mentioned in award #4, Mr. Waterhouse admitted that no capital improvements or capital expenses were definite and certain, just that the $320,000 escrow account would be spent. These fees are not correctly categorized costs of a capital improvement or a capital expense, as defined by the court, and do not meet the criteria of §11A-2, as specified by the award itself.

Exhibit Q contains many references to park infrastructure, but not one is associated with completed or definite and certain capital improvements. Most entries relate to administrative and operating expenses, such as the long-running dispute between management’s attorney and a specific homeowner, management’s participation in homeowners’ suit against the prior owner, consultations with the county on unspecified matters and other duties delegated by management to its attorney. Such expenses are not capital in nature. Without additional evidence to substantiate management’s claim

that Exhibit Q professional fees are capital improvements or asociated with capital improvements, the arbitrator cannot make an informed and impartial decision supported by adequate findings. Management's failure to meet the evidence standards of §11A-6 and §11A-5(f) prevents bridging the analytic gap between the raw evidence and the arbitrator's decision to award professional fees associated with capital improvements.

Award #6 violates the express provisions of the ordinance regarding capital improvements and capital expenses, as well as §11A-4(b): "The arbitrator shall set and adjust rents in accordance with the standards set out in this chapter."

Award #7: The Homeowners are to pay $40,000 for the A&E fees associated with the capital improvements.

The court ruled on page 27 that "…the arbitrator did not identify in his findings how the total was reduced to $40,000, as, for example, whether particular items were disallowed or whether the total was simply adjusted. Especially in light of the above discussion regarding the lack of findings as to permissable capital improvements and capital expenses, the arbitrator's findings are insufficient to determine whether the allowed fees are or are not 'costs' of capital improvements or capital expenses as permitted by the ordinance. In addition, the arbitrator's findings here may have been influenced by its erroneous determination as to the $320,000 escrow funds."

The board then remanded award #7 for abuse of discretion, adequate findings about the nature of these fees and, as specified in the arbitrator's December 2011 award, that they be associated with capital improvements.

Exhibits J and L show no evidence that A&E fees allegedly purchased from the prior owner are correctly categorized as costs of completed or definite and certain capital improvements. Page 1 of Exhibit L expressly states "Here are some of our expenses for our utility replacement project," including water, sewer, gas, electric and road trenching. As of the date of hearing, a utility replacement project was not definite and certain. Since all of Exhibit L relates to a utility replacement project that has not been completed

or planned by management, these fees are not correctly categorized costs of either a capital improvement or a capital expense, as defined by the court, and do not meet the criteria of §11A-2, as specified by the award itself.

To presume that management will eventually use $40,000 worth of these documents for future capital items is not an adequate finding to support this award. Here, again, award #7 lacks adequate findings to bridge the analytic gap between the raw evidence and the award of A&E fees associated with the capital improvements.

Award #7 violates the express provisions of the ordinance regarding capital improvements and capital expenses, as well as §11A-4(b): “The arbitrator shall set and adjust rents in accordance with the standards set out in this chapter.”

Award #8: The Homeowners are to pay $130,531 for the supplemental tax increase payments already paid by the park owner.

The court ruled on page 23 that “Thus, the supplemental assessment reflects an increase in property taxes within the meaning of 11A-5(f)(1) of the Ordinance. …The arbitrator was entitled under the Ordinance to consider the supplemental property tax assessments in determining the rate increase.“

The board then remanded #8 for abuse of discretion and adequate findings about the nature of the payment.

This award is specifically for supplemental tax increase payments or, as Judge Anderle ruled, supplemental tax assessments. Evidence of supplemental tax invoices issued by the county were not introduced by management for good reason: they do not total the alleged amount.

Mr. Ballantine identified this amount as an uncompensated increase on page 18 of his pre-hearing brief and on page 75 of the September 19th transcript, but thereafter referred to it as supplemental taxes. Had proper evidence of separate supplemental tax and uncompensated payments been presented, the award may have included

both, and the court may have included uncompensated tax increases in its mandate. Misrepresentation of the increase as supplemental taxes during testimony distorted the facts and created the illusion that the entire amount consists of supplemental taxes. The arbitrator's intention may have been to include the uncompensated increase in award #8, but, on the record, this award is specifically for supplemental tax increase payments. Management had ample time to request a clarification of the composition of this award while the record remained open for post-hearing briefs, but did not.

The court ruled that supplemental tax assessments may be considered by the arbitrator as a relevent factor under §11A-5(f)(1), but did not expand his ruling to encompass §11A-6. Since management elected to analogize supplemental tax increase payments under §11A-6, the court's ruling does not apply to treatment as capital improvements or capital expenses. Had management asked to amortize extraordinary uncompensated operating expenses over seven years at zero percent interest under §11A-5, it is within the arbitrator's discretion to do so, if evidence supports the increase, and the treatment would be beneficial to homeowners. Instead, this award specifies supplemental tax increase payments, confirmed by the court as supplemental tax assessments, totaling $31,533.96 according to the county's supplemental tax invoices.

On page 3 of his remand opinion and award dated August 6, 2012, the arbitrator says "…for years the Homeowners had not only paid the property tax assessments, but also the regular annual increases in the property taxes without protest. …the Homeowners, as in the past, should pay the Park Owner the full amount of the property tax assessment." No evidence of any sort was presented to support that presumption and the resultant finding. The only fact known is that the prior owner agreed in his lease for the land to pay landowners' property taxes.

Award #8 violates the construction and intent of the ordinance, including §11A-4(b): "The arbitrator shall set and adjust rents in accordance with the standards set out in this chapter."

Award #11: The Homeowners are to pay $110,000 for the legal fees associated with the challenge to the rent increase.

The court ruled on page 28 that "Baar's testimony is substantial evidence that legal fees, if reasonable in amount, are appropriately included as a basis for a rent increase as an ordinary and necessary operating expense." Also on page 28, the court ruled that including attorney fees as operating expenses may be considered as a relevant factor by the arbitrator **subject to the other requirements of the ordinance.** The court's ruling that the arbitrator did not abuse his discretion is a direct result of its finding on page 28, yet ignores the condition that attorney fees are subject to other requirements of the ordinance.

The board then remanded #11 for abuse of discretion and adequate findings about the nature of the fees.

Management's pre-hearing brief dated September 15th, 2011, claims that the rent increase is in accordance with the provisions of the ordinance, but that is not true.

§11A-5(a)(1) requires that a rent increase comply with state law. State law says that unless specifically provided for by an arbitration agreement or statute, or the parties expressly agree otherwise, each party pays all counsel fees, witness fees and other expenses incurred for his own benefit for arbitration and administrative hearings (Code of Civil Procedure Part 3, Title 9, Section 1284.2) and limits these fees to $7,500 for judicial review (CCP Section 1021). Unlawful professional fees associated with the challenge to the rent increase are not a relevant factor to be considered by the arbitrator under any circumstance.

Expert testimony regarding attorney fees as proper is not sufficient to countermand state law. When asked by Mr. Stanton to cite the authority in Chapter 11A that allows a rent increase for advance professional fees, Dr. St. John replied:

> "The ordinance explicitly allows capital improvements and is silent on the question of advance professional fees."
> (Sept. 20, page 12, lines 21–23)

> "I'm referring to the fact that the advance payment for capital improvements is allowed and by analogy, we believe—I believe—I'm not an attorney, I'm an economist, so this is a legal question, it seems to me."
> (Sept. 20, page 13, lines 2–6)

Other jurisdictions that allow attorney fees in their rent control ordinances do so because a park owner must request a rent increase before a commission or a board, as the Carson and Oceanside cases cited by the court's ruling confirmed. Mr. Ballantine said during the first day of hearing (Sept. 19, page 14, lines 8–25) that our ordinance is different: park owners must notice a rent increase, and homeowners must petition for arbitration if it is disputed. The relevant difference is that Chapter 11A provides for arbitration, which is regulated by Code of Civil Procedure Part 3, Title 9, Section 1284.2, while applications before a rent control commission or board are not.

In his post-hearing briefs, homeowners' counsel reiterated their objection to this award as improper.

Award #11 violates state law without homeowners' express agreement, as well as the construction and intent of the ordinance, including §11A-4(b): "The arbitrator shall set and adjust rents in accordance with the standards set out in this chapter."

Although not fully addressed in arbitration, compliance with state law is essential and presumed for all law professionals, including practicing attorneys who serve as neutral arbitrators. Whether out of ignorance, from faulty memory or by intent, without adherence to the law, they fail not only the people who must rely on their advocacy to achieve fairness and justice, but also the law itself. Management's counsel defied the law, homeowners' counsel did not dispute it, the arbitrator perpetuated it and the judge did not question its legality. Those actions should not void the terms of the ordinance, nor should it suppress the importance of the law in all serious matters that affect the lives and well-being of the public.