Attachment C
Homeowners' Arbitration Pre-Hearing Brief

BRUCE E.STANTON (SBN 104925)
LAW OFFICES OF BRUCE E. STANTON
6940 Santa Teresa Bld, Suite 3
San Jose, CA 95119
Telephone: (408) 224-4000
Facsimile: (408) 224-4022

Attorney for Petitioners, Mobile Homeowners

BEFORE THE COUNTY OF SANTA BARBARA

MOBILE HOME RENT CONTROL ORDINANCE

In re:	**HOME OWNERS' ARBITRATION PRE-HEARING BRIEF**
NOMAD VILLAGE MOBILEHOME PARK,	
	Arbitration Hearing Date: June 9, 2011
	Hearing Officer: Hon. Luis Esparza

Petitioners, NOMAD VILLAGE MOBILE HOMEOWNERS (hereinafter "Home Owners"), hereby submit the following pre-hearing brief and legal points and authorities in support of their Petition filed herein.

I.

STATEMENT OF FACTS

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

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

The park land is owned by a family trust, but is leased to the park operator. For many years, possibly as many as 50, a ground lease apparently governed this relationship. When that lease expired in 2008, it was not renewed with the former park operator. The current operator, Lazy Landing, LLC (hereinafter the "Park Owner"), signed a new 34 year lease effective August 1, 2008, which includes a monthly ground lease amount negotiated at the time of purchase that calculates rent as a twenty (20%) percent of the gross rental income received by the Park Owner. Due to the expiration of the prior long-term lease, the County apparently reassessed the local property tax due to a "change of ownership". It is undisputed that no annual rent adjustment, or rent increase of any kind, has been charged to residents since the current Park Owner assumed operations.

On January 26, 2011, Homeowners received a 90-day Notice of rent increase as required by law. Although it, and its attachments, are not a model of clarity, and tend to mix and match terms in such a way that it is confusing and difficult to decipher, it is apparent that three distinct rent amounts are being sought:

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

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

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

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

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

II

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

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

The first is rather confusing, but appears to allege that since the $161.00 sought in addition to the cumulative annual "75% of CPI adjustment" is not "rent", but has been labeled by the Park Owner as something else, it is not reviewable. In fact, a portion of the $161.00 is requested to be permanent, and thus cannot be anything <u>but</u> base rent in character. It will be

charged monthly for the use of the mobilehome space, and clearly is part of the "noticed increase" as that phrase is used in Ordinance sec. 11A-5 (a), (b) and (d). Review by a hearing officer is not limited only to amounts which the Park Owner might choose to label as "base rent", but applies also to a review of capital expenses or increased operating expenses which the park owner might attempt to capitalize and pass through to the residents as a "temporary increase". Support for this appears in Ordinance sec. 11A-5 (a) (3), which requires that such amounts be itemized in the notice of increase (which the Park Owner attempted to do), and again in sec.s (4)-(6) thereof, which allow the hearing officer to award amounts to cover increased costs of capital expenses, new or old, or capital improvements. Clearly the items which comprise the $161.00 are subject to review once a hearing is requested, as here. Otherwise, a Park Owner could "end run" the Ordinance by calling these increase amounts something else, and realize large increases in monthly rental charges without any review. It is the entire "increase" which must be measured, and here the $161.00 amount is required to be reviewed. Thus, this objection should be overruled.

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

III

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

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

1. General Objections and Observations

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

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

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

Ordinance sec. 11A-1 states that as an overriding purpose, the Ordinance is designed to ensure that a park owner receives "a fair return on their investment". An inquiry into fair return is thus appropriate. Any fair return analysis should be fairly used, and MNOI fits the bill. The fact that the park owner's own expert has chosen this theory to presumably verify the Park Owner's requested increase amounts establishes that it can and should be used by this Hearing Officer as an objective and court-tested standard by which the "reasonableness" of the requested rent increase can be determined. But as stated below, this MNOI theory that the park owner has

chosen, and which the Homeowners will accept as the standard to use, must be properly applied, and there are numerous questions and errors in the St. John work which must be corrected and sorted out.

2. Specific Objections and Challenges

A. Property Tax Increase

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

-This amount, which the "Notes" attached to the Rent Increase summary sheet state shall not be "passed through" if a challenge to the assessment is successful (thus tacitly admitting that this increase is being attempted as a 'pass through'), may not even legally be owed, and thus should not be allowed until any legal challenge is completed (although it appears that the park owner has not yet even initiated any such challenge, and indeed may be waiting for the Hearing Officer to award its projected attorney's fees first before it would do so!). The real questions are: What is the basis for any such challenge? Why does the park owner feel so strongly about it? And what chance does the Park Owner have to succeed?

-The amounts have not been correctly calculated even if one were to accept the manner in which they are presented. The detailed income and expense sheet produced by Park Owner shows actual property tax expenses of $21,199.58 in 2008 and $59,255.26 in 2009, which would yield a different result when using the differential to calculate a rent increase. Assuming such a "stand

alone" theory was used, the actual difference would be $38,055.68, and not the $46,070.00 amount claimed.

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

B. Lease Payment Increase

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

-The ground lease payment is not an operating expense, but rather an investment expense incurred by the Park Owner in connection with the acquisition of the park. It is a payment from one owner to another, made in connection with the purchased right to control the land. As such, it is a bargained for part of the purchase price, and not an expense. MNOI calculations would typically not allow such an item, since it is circular in nature (i.e. an increase in revenue increases the ground lease payment, which in turn requires an even greater increase in revenue, and so forth), and thus iterative.

-There has been no production of the former lease agreement, pursuant to which it is claimed that former ground rents were calculated based upon 10% of gross income, as opposed to 20%.

-Even if the manner of presentation in item 2 of the increase summary is accepted, the calculation is incorrect. According to the income and expense detail, the actual paid lease amount in 2008 was $83,288.42, and not $54,905.00. Thus, the actual differential between 2008 and 2009 is $30,238.00. (Together with the corrective calculation above, this yields a total difference between 2008 and 2009 for Permanent Increases of $68,293.68, which would result in a rent increase of $37.94 even if this 'stand alone' theory was proper).

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

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

But there are a number of errors and omissions in the St. John work which must be addressed. Some are errors in calculation. For example, a significant error is made in calculating property tax expense for 2009 (see page 2 of MNOI analysis), which the accompanying calculation notes indicate to be stated "net of sewer service". But the $112,111.12 figure shown still includes the $54,587.91 in sewer fees billed to the Park Owner for 2009. The correct figure should be $66,523.00, as noted in item 1. On the rent increase summary sheet. Elsewhere, the 2009 MNOI calculation shows an amount of $52,366.27 for

sewer expense; a number which cannot be accurately traced. Reducing the 2009 expense total by this $54,587.91 amount in turn reduces the authorized MNOI increase to $30.29 at 100% indexing, and to $20.20 at 75% indexing.

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

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

-Why was 1994 chosen for the base year?

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

-How was the "current year" of 2009 chosen?

-What was used to calculate rental income? Are rent rolls available for Homeowners' inspection?

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

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

IV

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

To repeat, Homeowners are unsure, based upon the submission of documents so far, as to the exact basis for many elements of the total rent increase sought, and shall reserve their right to expand upon their list of objections both during the hearing, at closing argument and in post-

hearing briefing once the evidentiary portion of the hearing is concluded. But based upon what has been submitted so far, Homeowners shall be objecting to the increase amounts labeled as "Temporary Increases" in the Park Owner's increase summary sheet (Items labeled as 3 through 6) based upon the following:

1. General Objections and Observations

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

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

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

between the amount sought and the projected work to be done. Bids, invoices, and proposals are needed here, rather than vague lump sum estimates which could potentially be allocated anywhere. The absence of any sort of cost estimate again makes this request premature and unsupported.

-Ordinance definitions of a "capital improvement" and a "capital expense" must be met in order to authorize the increase; i.e. the "addition or betterment" must be identified, or the "existing facilities or improvements" for which the expected repair or replacement adds an expected life of at least one year. Until the specific work is identified by type and cost, these definitions, found in Ordinance sec. 11A-2, cannot be established.

-"Anticipated Professional Fees", including legal fees, which are claimed as capital items in items 3, 5 and 6 need to be specifically explained and accounted for, as well as supported by good faith estimates. Such items are not considered as capital expenditures, and thus cannot be amortized and passed through, where their inclusion would violate Internal Revenue Service precedent. In Revenue Ruling 78-389 (1978-2 Cum. Bull. 125), the Service found that legal expenses incurred in the prosecution of a suit to invalidate as municipal ordinance that would prohibit the operation of a taxpayer's business were deductible as ordinary and necessary business expenses when they arose from the taxpayer's business activities and did not result in the acquisition or disposition of a capital asset.

2. Specific Objections and Challenges

A. Capital Improvements

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

B. Uncompensated Increases

This category attempts to pass through retroactively, supplemental tax and land lease allegedly incurred in 2008 and 2009, and for which the park owner chose not to previously seek any increase during those years. There is no precedent in the Ordinance for such a theory, which if allowed would enable a park owner to go back in time any number of years to allege that an expense increase, or one-time payment of some type, had not been fully compensated. These are

not capital items, and are subject to the same analysis set forth in Headnote III above. These amounts are compensated as a part of the three years of automatic CPI increases which will be allowed by the Hearing Officer. They were never noticed when incurred, and recovery was never sought when the expense was incurred. To allow them now would create a precedent for retroactive recovery which would make such expenses difficult to track or prove, and which would keep Homeowners at risk of having to pay rent increases to cover new expense item whenever discovered, or whenever the park owner might get around to requesting them. This would also create chaos and play havoc with prior increases ordered based upon facts and data then presented, which could be turned on its head by new "expenses" claimed in later years for the same periods.

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

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

C. Anticipated Professional Fees – Property Taxes

This is clearly not a capital item, since it does not relate to the acquisition or disposition of a capital asset, and because it is prospective as per its definition it has not yet become an expense of the Park Owner. If actually incurred, the Park Owner is free to include this amount in a future rent notice, where it can be properly analyzed and adjudicated under the Ordinance. Furthermore, no basis for the expense has been disclosed; i.e. it is unknown who the fees would be paid to, what they would seek to accomplish and what good faith basis, if any, exists for

achieving any benefit to the Homeowners. The fact that the Park Owner has not, to date, initiated any such challenge speaks volumes about the confidence level in such a pursuit, and how Homeowners would in any way be "bettered" by such a cost. Homeowners cannot be expected to fund what could turn out to be fruitless legal challenges, and provide the Park Owner with the equivalent of an attorney's fee guarantee, even if the Park Owner were to lose.

D. Anticipated Professional Fees – Rent Increase

This category represents a complete unknown at this point. But it can be inferred, due to the huge amount projected that it encompasses not only the legal fees require for this 1-2 day hearing, but also fees to fund a projected appeal through the courts if the Park Owner were to lose all or any portion of its case at the administrative level. For that reason, all of the arguments set forth in (C) above would apply to this item.

In addition, there is no authority to prospectively pass through attorney's fees incurred to obtain a rent increase on a dollar for dollar basis. Once they are actually incurred, such fees could be included as an expense item in a fair return calculation for a future year. *See Galland v. City of Clovis (2001) 24 Cal. 4th 1003*. But merely projecting a lump sum of fees which are anticipated, and then seeking to pass that amount through with financing costs apparently included, is not authorized by the Ordinance, or by any known authority. Again, it is unknown to whom these fees would be paid, for what and in what amounts. The Ordinance does not allow for the writing of such a "blank check".

V

SUMMARY OF HOME OWNERS' POSITION

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

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

Dated: June 6, 2011

BRUCE E. STANTON, Esq.
Attorney for Home Owners