

## SANTA MONICA RENT CONTROL BOARD ADMINISTRATION MEMORANDUM

DATE: May 7, 2009  
TO: Santa Monica Rent Control Board  
FROM: Tracy Condon, Administrator  
FOR MEETING OF: May 14, 2009  
PUBLIC HEARING ON: June 11, 2009  
RE: 2009 Annual General Adjustment  
Apartment Operating Cost Increases (March 2008 - March 2009)

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### Summary

The recommended annual general adjustment for 2009 is **1%** with a floor (or minimum increase) of \$8 and a ceiling (or maximum increase) of \$16. The floor would not apply to mobile home spaces. The general adjustment recommendation is based on changes in property owners' operating expenses from March 2008 to March 2009.

Actual and estimated changes in various expense components of the rent dollar are analyzed using a formula of the "component ratio to gross rent", or what is also referred to as the "pie" methodology because each individual category of a property owner's operating expenses has been assigned a portion or "slice" of the total rent dollar. The Rent Control Board has adopted and used this methodology for many years, with rare adjustments as changes in component ratios or introduction of new components have been warranted.

Due to the current economic climate as indicated by the most-recently reported negative consumer price indexes, this year staff is recommending no adjustment be made to some of the expense components. This is discussed further in the report.

### Recommendation

Staff recommends the Rent Control Board set a public hearing on June 11, 2009 for consideration of a **1%** general rent adjustment (GA). It is also recommended that the Board set a floor, or minimum increase, of \$8, excluding mobile home spaces. Staff further recommends that the Rent Control Board adopt a ceiling or maximum adjustment of \$16. The recommended ceiling was calculated by applying a 1% general adjustment to the average (\$1,562) of the 85th percentile of rents for all units including market rate units (\$1,952) and non-market rate units (\$1,171).<sup>1</sup> Public participation in the hearing is encouraged.

**Note:** Units with market rate increases implemented from September 1, 2008 through August 31, 2009 are not eligible for the 2009 general adjustment. Owners with recent market rate rentals will have taken operating costs into account when establishing a new rental rate.

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<sup>1</sup> Based on a consultant's report: "Operating Expenses and General Adjustment Methods – 1998" by Thomas D. Stringer.

## Overview

This year's general adjustment will be decided in an economic climate not seen since the mid-1950s. The Rent Control Board's adopted and long-standing formula for calculating each year's general adjustment—the Component Ratio to Gross Rent—examines cost changes in property owners' operating expenses over the previous year.

For some expense components--property taxes, water and sewer costs, refuse, common area utilities and fire inspections--actual cost or set percentage increases are available. The water and sewer component is of interest this year due to rate restructuring and increases implemented by the City Council in August 2008. This year's general adjustment recommendation includes adjusting this component by the full increases authorized by the City Council: 11% for water costs and 18% for sewer costs (pages 7 and 8). Common area electricity costs are also adjusted this year to reflect a change in the rate schedule that Southern California Edison is implementing for "house meters" (pages 10-12).

For other expense components--maintenance, insurance, self-labor, cash flow and management costs--the most recently reported changes in two consumer price indexes for the Los Angeles area are used to determine each component's cost change over the preceding 12 months. Both March 2008 to March 2009 Consumer Price Indexes (CPI) used in the Board's formula are negative this year.<sup>2</sup> A Bureau of Labor Statistics (BLS) news release issued April 15, 2009 discussed changes in the March 2008 – March 2009 national index and stated, "The index has decreased 0.4 percent over the last year, the first 12 month decline since August of 1955."

A representative from the Bureau of Labor Statistics informed staff that regional data for the Los Angeles area index for CPI-All Items has been maintained since 1914. A 12-month decline in the CPI-All Items index has not been seen since June of 1955. The CPI-All Items Less Shelter index for the Los Angeles regional area has been tracked since 1975 and, other than the current period, has never shown a 12-month decline. Despite these negative changes in the indexes, there is little evidence locally that operating expenses adjusted by the CPI in the Board's formula have actually decreased over the past year.

Given the rarity of this level of decline in the consumer price index, staff believes an alternative approach is warranted in the treatment of operating expenses normally adjusted by the CPI. Staff recommends rather than applying the negative CPI indexes to the above-stated components, for this one time, no adjustment be made to those costs (pages 12-15). Instead, the decreases to these components will be delayed and reconsidered when analyzing the 2010 general adjustment. The average costs used in the 2008 formula for these components will be used as the average costs for the 2009 calculations.

## Methodology

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<sup>2</sup> Consumer Price Index (Los Angeles-Riverside-Orange County), All Urban Consumers, (CPI-U), 12-Months Percent Change from March 2008 – March 2009

- All Items Index = -1.0%
- All Items Less Shelter Index = -2.7%

Actual or estimated cost changes in owners' operating expenses over the previous 12 months are applied to each expense component's cost from the prior year to determine the average cost to be used for the next general adjustment. As directed by the Rent Control Charter Amendment, this is a formula of general application and, therefore, it is not possible for the formula to address the range of expenses incurred by each individual property owner throughout the City. There will always be differences between the average costs used in the Board's formula and actual costs for individual property owners.

The expense components adjusted by actual changes in rates or established set increases include: property taxes, refuse, water and sewer, gas, electricity, and fire and life safety inspections conducted by the Santa Monica Fire Department. The remaining components are usually adjusted by changes in the March to March CPI index (CPI-All Items for management costs, self labor and cash flow, and CPI-All Items Less Shelter for maintenance and insurance). Debt Service is not adjusted.

The consumer price indexes measure the average change during the twelve month period beginning March of the prior year and ending with March of the current year. It is the average change for a specific twelve month period that is used to calculate how much of a general adjustment is needed to compensate property owners for any increases in the average cost of expenses. If the costs of various goods and services decrease, those changes would normally be reflected in the general adjustment.

Due to the uniqueness of the current negative price indexes, the lack of evidence of local cost reductions, and the uncertainty of how long this economic downturn will continue, this one time it is recommended that no adjustment be made to the dollar values of the components usually adjusted by the CPI indexes. Decreases that would have resulted from the application of the negative consumer price indexes this year will be delayed and reconsidered when analyzing the 2010 general adjustment.

A detailed analysis of each expense component begins on page 5 and more information about the Board's methodology is contained in Appendix 1.

### **Long-Term Controlled and Market Rate Rental Units**

#### **General Adjustment Specified Dollar Floor and Ceiling Amounts**

By the end of 2008, more than half of the controlled rental units in Santa Monica had been rented at market rate since vacancy decontrol/re-control began in 1999. In two Board-commissioned studies, one conducted by professional appraiser Thomas Stringer in 1997 and the other conducted by economist Dr. Kenneth Baar in 2002, both consultants found that operating cost increases for a rental unit are not substantially related to the rent collected for that unit.

Apartments with low rents tend to experience most of the same cost increases as apartments with higher rents. The 1% recommended general adjustment for a unit with a rent below \$750 may not provide enough of an increase to cover the actual costs. Therefore, a minimum increase of \$8 is recommended for units with rents below \$750.

Conversely, units that have received large vacancy increases do not have to receive larger annual rent increases. In most cases, when establishing a market rate rent upon vacancy, owners obtain increases far exceeding the increase in the CPI and the amounts that have been calculated in the annual general adjustment studies as necessary to cover operating cost increases. The

recommended ceiling of \$16 is calculated by applying a 1% general adjustment to the average of the 85th percentile of rents for all units including market rate units (\$1,952) and non-market rate units (\$1,171) or \$1,562. A maximum increase of \$16 is recommended for all units with rent levels at or above \$1,650.

No floor is recommended for mobile home spaces. When a floor has been adopted by the Board in the past, the Board’s policy has been to not apply the floor to mobile home space rents. Previous Board analyses have shown that the dollar increase realized by applying the percentage increase to mobile home space rents has been sufficient to cover the increases in their operating expenses.

### Dollar Value General Adjustment Components

The recommended 1% general adjustment results in a rent of \$787.84 for the hypothetical average apartment used in the general adjustment calculation. (See Table A on page 16.) The Board’s Component Ratio to Gross Rent formula assigns each operating expense category a portion or “slice” of the total rent dollar. The “slices” represent the percentage of the average rent dollar available for each expense category as shown in the pale yellow column (1) in the table below.

The bright yellow column (A) represents the hypothetical average unit with a rent of \$787.84. The light blue column (B) reflects the current median maximum allowable rent (MAR) of \$791 for all units that have not received any market rate increases. The purple column (C) reflects the current median MAR of \$1,260 for all units (long-term controlled and market rate), and the orange column (D) reflects the current median MAR of \$1,650 for units rented at market.

The columns show the dollar amounts available for each of the operating expense components when the same ratios (pie slices) are applied to various median rent levels. As the rent level increases, the amount available for each of the expenses rises proportionately. For example, on the unit with a MAR of \$787.84 the general adjustment formula provides \$66.09 available for the property tax expense; while on a rent of \$1,650, \$138.41 is available.

<b>Component</b>	<b>(1) 2009 Ratio to Gross Rent</b>	<b>(A) 2009 Rent \$787.84</b>	<b>(B) Median No Market Rents \$791.00</b>	<b>(C) Median All Units \$1,260.00</b>	<b>(D) Median Market Units \$1,650.00</b>
Property Taxes	8.39%	\$66.09	\$66.36	\$105.70	\$138.41
Refuse	2.31%	\$18.18	\$18.25	\$29.08	\$38.07
Fire & Life Safety	0.11%	\$0.89	\$0.90	\$1.43	\$1.87
Water & Sewer	3.42%	\$26.94	\$27.05	\$43.09	\$56.42
Gas	3.03%	\$23.88	\$23.98	\$38.19	\$50.01
Electricity	1.61%	\$12.71	\$12.76	\$20.33	\$26.62
Maintenance	14.22%	\$112.07	\$112.52	\$179.23	\$234.71
Insurance	4.05%	\$31.94	\$32.07	\$51.08	\$66.89
Self Labor	7.20%	\$56.76	\$56.99	\$90.78	\$118.87
Debt Service	15.80%	\$124.51	\$125.01	\$199.13	\$260.77
Cash Flow Management	34.84% 5.00%	\$274.50 \$39.39	\$275.60 \$39.55	\$439.01 \$63.00	\$574.89 \$82.50
<b>Total Rent 2008 (w/2.7% GA)</b>		<b>\$780.04</b>	\$791.00	\$1,260.00	\$1,650.00
<b>Total Rent 2009 w/1.0% GA</b>		<b>\$787.84</b>	\$798.91	\$1,272.60	\$1,666.50
Dollar difference		\$7.80	\$7.91	\$12.60	\$16.50
					\$16 - ceiling

## COMPONENT CALCULATIONS

This section contains a detailed analysis of cost changes for each operating component. Table A on page 16 shows the changes to each component and the overall calculation of the general adjustment of 1%. The pie chart on page 17 shows the “pie slice size” for each expense component after applying the recommended adjustments.

### Actual Cost Changes

#### Property Taxes

Property tax increases post-Proposition 13 are limited to a 2% increase per year, except when properties are reassessed to market value, which occurs upon a transfer. The 2% limit is used in calculating the property tax component of the rent dollar.

Although each year there are some properties that are sold or transferred, to use an average of property tax increases due to transfers each year would substantially over-compensate owners of properties which have not been sold, as those owners continue to operate with property tax bills which typically increase by no more than 2%. Increases significantly greater than 2% were used in 1989, 1992 and again in 2002. In 2002, the property tax component was increased by 28.6% based on Dr. Baar’s analysis of property tax bills for a random sample of 272 properties. The significant increase was related to a reassessment of properties that transferred ownership since 1995, when vacancy decontrol was enacted statewide.

Following the significant increase in this component in 2002, staff has used a 2% increase for the property tax component. The table below reflects the 2% increase for 2009.

Year	Average Monthly Property Tax Bill Per Unit
1978	\$19.20
2001	44.74
2002	57.53
2003	58.68
2004	59.85
2005	61.05
2006	62.27
2007	63.52
2008	64.79
2009	66.09

	2008 Average Monthly (per unit) Property Tax Bill	Rate Increase 2008-2009	Cost Increase Apt/Month	Estimated 2009 cost
<b>Property Tax</b>	<b>\$64.79</b>	<b>2%</b>	<b>\$1.30</b>	<b>\$66.09</b>

## Refuse Collection

Refuse collection charges consist of fixed charges per apartment and collection fees dependent upon the type of refuse container and the frequency of collection.

There are several types of containers and various options as to the frequency of collection. Over the years, the Rent Control Board has reviewed refuse bills for a variety of apartment buildings and has calculated average expenditure levels. The "typical" configuration (type of refuse container and frequency of pick-up) used for this report is based on a ten-unit building using two 2-yard bins picked up once a week.

Between 1999 and June 2004, the fixed charge (monthly fee per apartment) did not vary and held at \$3.00. Since July 2005 the fixed charge rates and the collection rates are increased effective July 1 of each year. Effective July 1, 2008, the monthly fixed charge rate was set at \$3.79 which reflects a 3.7% increase. Collection rates were also increased by 3.7% effective July 1, 2008. The table shows the impact of the rate increases on the overall cost for a hypothetical typical apartment.

Monthly Refuse Collection Charges per Apartment  
(Hypothetical 10 Unit Building)

	<u>Monthly Fee per Apartment</u>	<u>Bin Charge</u>	<u>Total Bill</u>
April 2004	3.00	11.20	14.20
April 2005	3.00	11.40	14.40
April 2006	3.30	12.54	15.84
April 2007	3.53	13.42	16.95
April 2008	3.65	13.88	17.53
April 2009	3.79	14.39 <sup>3</sup>	18.18

The difference between the 2008 total bill calculated as \$17.53 and the projected cost of \$18.18 for 2009 reflects a 3.7% increase.

	2008 Average Monthly Cost Per Apt. Unit	Percent Cost Increase 2008-2009	Cost Increase Apt/Month	Estimated 2009 cost
<b>Refuse Collection</b>	<b>\$17.53</b>	<b>3.7%</b>	<b>\$0.65</b>	<b>\$18.18</b>

<sup>3</sup> The rate for the class MSQ - one 2-yard bin picked up once weekly was increased from \$138.74 to \$143.87 per two month period. The analyses developed by staff assume two bins for such a ten-unit building, resulting in a cost of \$143.87 per month or \$14.39 per unit/per month.

## Fire and Life Safety Inspection Fee

This component was added for the first time in the 2005 general adjustment calculation. Fire and Life Safety Inspections are required of all apartment buildings in Santa Monica. Since January 2004, property owners have been charged a fee for the inspection. The 2005 annual cost of the inspection was a flat fee of \$60 per building.<sup>4</sup> The average number of units per building used for most components in the Board's general adjustment calculations is six units per building. Therefore, a monthly per unit cost of \$0.83 per unit (\$60 divided by 6 units divided by 12 months) was set in 2005 and established the "base" cost for this component. The fee was increased to \$64.34 as of July 2008.<sup>5</sup> The monthly per unit cost for 2009 is projected to be \$0.89 (\$64.34 divided by 6 units divided by 12 months). This represents a 7.2% increase in the cost for this component.

	2008 Cost Per Apt. Unit	Percent Cost Increase 2008-2009	Cost Increase Apt/Month	Estimated 2009 cost
<b>Average Fire &amp; Life Safety Inspection Expense</b>	<b>\$0.83</b>	<b>7.2%</b>	<b>\$0.06</b>	<b>\$0.89</b>

## Water and Sewer

On July 8, 2008, the City Council adopted a five-year rate schedule for water and sewer (wastewater). The new schedule reflects a change in the rate schedule to a commodity-only structure. The fixed bi-monthly service charge was eliminated and a four tier commodity schedule was established. (Previously a three tier schedule was in use.) This change was made to promote water efficiency and conservation.

Pursuant to City Council Resolutions (CCS) 10322 and 10372, the first rate increase under the new schedule was implemented as of August 1, 2008. The water rates were increased by 11% and the sewer (wastewater) rates were increased by 18%. This year's general adjustment allows the total increase of 11% on water rates and 18% on sewer rates.

In recent discussions, the Board has indicated its commitment to encouraging water conservation in controlled rental units. The Board intends to include information and suggestions on this topic in its summer mailings to all tenants and property owners.

<sup>4</sup> City Council resolution 9858 adopted on June 17, 2003 established the fees.

<sup>5</sup> Effective July 2007, the rate increased from \$60 to \$62.04. While preparing the 2008 general adjustment report, staff contacted the fire department to obtain information about the cost of the inspection fee. It was reported there were no changes to the fee. Therefore, the general adjustment report for 2008 did not reflect the July 2007 increase. In this report, the 2007 and 2008 fee increases have been incorporated.

## Water and Sewer Average Costs

Water and sewer charges are considered together as the costs for both are made up of fees related to water consumption. Two factors influence the average water/sewer costs used in the general adjustment calculation: actual water and sewer (wastewater) rates and water consumption. Typically, increases in water and sewer rates have been equal, and increases have been projected on the combined water and sewer expenses to determine the total cost for the water and sewer component. The rate increases for water and sewer are no longer equal and the increases to this component are now calculated individually.

In the 2006 general adjustment report the water and sewer expenses were separated due to different rate increases at that time. The amount of \$21.66 used for 2006 included both the rate changes and an increase in the rate of consumption. Using that figure as a starting point, the proportion of the water expense to the total water/sewer expense is 48.615% and the sewer expense is 51.385%. Applying these ratios to the 2008 water/sewer component (\$23.51), results in the following 2008 costs for each item: \$11.43 for water and \$12.08 for sewer.

The table below reflects the full 11% increase to the 2008 water expense of \$11.43 and the full 18% increase to the 2008 sewer expense of \$12.08. The last line in the table sets out the recombined water and sewer expenses. The 2008 and 2009 costs use an average consumption factor of 4.85 HCF per unit per month. (Details about water consumption and the effect of the new rates on consumption and costs are detailed in Appendix 2.)

	2008 Average Monthly Cost per Apt	August 1, 2008 rates	Cost Increase Apt/Month	Estimated 2009 cost
Average water expense	\$11.43	11%	\$1.26	\$12.69
Average sewer expense	<u>\$12.08</u>	18%	<u>\$2.17</u>	<u>\$14.25</u>
Total Water/Sewer Expense	23.51	14.59%	\$3.43	\$26.94

The water and sewer expense for 2009 has been projected using the 11% and 18% increases. The net effect of the combined increases is \$3.43 or a 14.59% increase. Staff will monitor consumption and average water costs during the next year. It is too early to fully evaluate what impact the new rate structure and the City's anticipated Water Shortage Response Plan (scheduled to be considered by the City Council at their May 12<sup>th</sup> meeting) will have on consumption and overall costs. If the data collected indicates any adjustments to costs or consumption averages (upward or downward) are warranted, they will be considered in next year's general adjustment report.

The Water Department will implement the second of the five increases (adopted by City Council in July 2008) effective July 1, 2009. The Resolutions (CCS) 10322 and 10372 set forth the maximum increases that will be allowed for 2009 through 2012. At this time, it is unknown what percentages will be authorized for 2009. Any adopted increases will be considered and incorporated in next year's report.

## Gas – Common Areas Only

### Average Costs

In more than two-thirds of all apartments, the apartment owners pay for hot water heating through master-metered service, while the tenant usually pays for gas heat for the unit on an individual meter.

For purposes of calculating the average monthly cost of gas per unit staff uses a consumption level of 16.036 therms per unit per month. This consumption level was established in the 2003 general adjustment report and was related to a modification of the gas component per Dr. Baar's recommendation in 2002.<sup>6</sup>

The average gas expense includes the actual cost of gas, which is made up of a procurement cost and a transmission charge, several incidental charges, which include a daily charge, a surcharge for Low Income Discount Rate Surcharge (Public Purpose Programs) and a surcharge for the State Regulatory Fee (Public Utilities Commission Reimbursement Fee), and a 10% Santa Monica Utility Tax.

### Cost of Gas

Staff uses the average of gas costs in a twelve month period to calculate the overall effect of changes in gas rates. The cost of gas is based on two components, the procurement cost, which changes monthly, and the transmission charge, which remains constant throughout the year. The average procurement cost for the most recent twelve months (April 2009 back through May of 2008) is .690945. The annual transmission charge for this period is .290560. The total monthly cost per therm is .981505 (.690945 + .290560). This is the amount used to calculate the estimated cost for gas for 2009. The projected total cost for gas for 2009 is \$17.31 which is \$0.11 less than last year's cost.<sup>7</sup>

### Incidental Charges

Only one of the items included in the incidental charges realized a rate change since last year. Effective January 1, 2009, the Public Purpose Program surcharge was increased by \$0.0131 cents (from .05074 cents per therm to .06384 cents per therm). This change resulted in an overall increase of \$0.23 to the incidental charges. The projected cost for incidental charges for 2009 is \$6.56. The gas cost and incidental charges for 2008 and 2009 are shown on the following page. The 2009 estimated cost is shown in the table that follows.

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<sup>6</sup> In the 2002 GA report, Dr. Baar recommended modification of the average gas component to equal \$9.62. His recommendation was based on the results of a survey of average cost data from Southern California Gas for the period April 2001 through March 2002. A random sampling of 258 buildings with 3369 apartment units indicated the average monthly gas cost was \$9.62 per apartment unit. In the 2003 GA report staff incorporated Dr. Baar's recommendation and modified the total gas expenditure for 2002 to equal \$16.03 (\$9.62 gas cost plus 10% tax and other incidental costs gas users are required to pay). The \$9.62 gas cost reflects a consumption level of 16.036 therms per month per apartment.

<sup>7</sup> 2009 per therm cost of \$0.981505 x 16.036 therms = \$15.74 plus 10% tax = \$17.31.

### Gas Cost and Incidental Charges

	2008	2009
Gas	\$17.42	\$17.31
Incidentals	<u>6.33</u>	<u>6.57</u>
	\$23.75 <sup>8</sup>	\$23.88 <sup>9</sup>

### Common Area Gas Expense

	2008 Average Monthly Cost per Apt. unit	Rate Change 2008-2009	Cost Increase Apt/Month	Estimated 2009 cost
Common area average gas expense	\$23.75	0.53%	\$0.13	\$23.88

### Electricity – Common Areas Only

In 2002, the average monthly cost per unit for common area electricity was set at \$10.68. The general adjustment reports for 2003 and 2004 did not project any additional changes to this component. In 2005 per Assembly Bill (AB)1X, Southern California Edison issued Regulatory Advice letter #1886-E, which resulted in a roll-back of rates to the February 2001 rates for Tier 1 (baseline) and Tier 2 (non-baseline level 1). The rates were set at 11.808 per kWh (baseline, Tier 1) and 13.741 per kWh (Tier 2). The rates for Tiers 1 and 2 have been limited to the 2001 levels from 2005 through the present.

### Consumption

The level of consumption used in the general adjustment reports indicates usage for common area electricity to fall within Tiers 1 and 2. As the rates for these tiers have been limited to the 2001 rates, there has been no increase to this component since that time.

In preparation of this year's report, staff attempted to obtain consumption and cost information for common area electricity in multi-family rental properties in Santa Monica. Southern California Edison refers to these meters as "house meters". An employee for the Edison Company indicated such a report could be produced and made available. The information was requested in early March, but a report has not yet been provided. If the report from the Edison Company can be obtained, the data will be used in next year's report. Until additional information about average consumption for common area electricity is received, staff will continue to follow the assumption that common area electricity usage falls within Tiers 1 and 2.

<sup>8</sup> April 2008 Cost \$17.42 (16.036 therms x .987510 baseline rate = \$15.84 + \$1.58 [10% tax]) + incidentals \$6.33 (daily service rate [30 days x .16438] + State Regulatory Fee [16.036 therms x .00068] + Low Income Discount Rate Surcharge [16.036 therms x .05074] = \$5.75 + \$0.58 [10% tax]) = **Total cost \$23.75**.

<sup>9</sup> April 2009 Cost \$17.31 (16.036 therms x .981505 baseline rate = \$15.74 + \$1.57 [10% tax]) + incidentals \$6.57 (daily service rate [30 days x .16438] + State Regulatory Fee [16.036 therms x .00068] + Low Income Discount Rate Surcharge [16.036 therms x .06384] = \$5.97 + \$0.60 [10% tax]) = **Total cost \$23.88**.

### Average Costs

Common area electricity cost used in the general adjustment report is based on figures provided in Southern California Edison's rate sheet known as Schedule D. When staff spoke to the Edison employee about obtaining the consumption and cost data, new information about the rate schedule typically used for "house meter" customers was provided. According to the Edison representative, customers with house meters who were previously on Schedule D are being switched to Schedule GS-1. The conversion process is underway, although it may not be complete until some time in late 2009.

It is likely some Santa Monica rental property owners have already been switched to the GS-1 Schedule. Staff has examined the effect the schedule change will have on common area electricity rates. The 2009 composite rate used per kWh for the GS-1 rate schedule is 17.03 cents/kWh, and only one tier or rate level is used. Tiers 1 and 2 of Schedule D are 11.8 cents/kWh and 13.7 cents/kWh, respectively. The composite of both tiers is 12.1 cents/kWh. This is the composite rate Edison uses to assist customers in comparing costs between schedules. The composite figures for both schedules include the customer daily service charge.

At this time, it is unknown how many property owners have already been affected by this change. It is also unknown how many property owners will see the change from schedule D to Schedule GS-1 in the months to come. What is known based on the information from Southern California Edison is that some property owners in Santa Monica have already seen the change in schedules. Therefore, staff has taken one-half of the percent change in rates and will apply that percentage to the 2008 cost for electricity. The total percent difference in cost per kWh is 42.98% and one-half of that is 21.49%.

GS-1 – Composite cents per kWh	Schedule D – Composite cents per kWh	% change	½ of % change
17.30 cents	12.1 cents	42.98%	21.49%

The following table shows the 2009 cost for common area usage and reflects the cost increase (adjusted by one-half) based on the change to Schedule GS-1. Staff hopes the report regarding average consumption and costs will be provided in the near future. Staff will also try to obtain more detailed information about the conversion to the GS-1 schedule. Any new information about the consumption levels and or costs for common area electricity will be considered in next year's report, and any necessary adjustments (increases or decreases) can be made at that time. The estimated 2009 unit cost for common area usage when the 2008 cost of \$10.46 is adjusted by 21.49% is shown below.

	2008 Average Monthly Cost per Apt. unit	Rate Change 2008-2009	Cost Change Apt/Month	Estimated 2009 unit cost
<b>Common area average electricity expense</b>	<b>\$10.46</b>	<b>21.49%</b>	<b>\$2.25</b>	<b>\$12.71</b>

## **Properties with Master-Metered Electricity**

The information obtained about the switch from Schedule D to Schedule GS-1 was specific to properties with meters identified as "house meters", which are typically used to monitor electricity use in common areas. Properties that are master-metered are not ordinarily included in the "house meter" category. No current information is available to contradict staff's assessment that properties with master-meters have consumption levels that generally fall within the allocations provided by Tiers 1 and 2 of Schedule D. The rates for Tiers 1 and 2 have not been increased since 2001 pursuant to Assembly Bill (AB) 1X and Edison's Advice letter #1886-E. Therefore, as the rates have remained the same, no additional utility adjustment is warranted for properties with master-meters.

Staff will continue to pursue information about consumption levels and costs for master-metered properties from Southern California Edison. If the information is obtained, it will be used in the 2010 general adjustment analysis. If an additional utility adjustment is warranted at that time, staff will make the appropriate recommendation.

### **Estimated Cost Changes Based on Changes in the Consumer Price Index**

As explained earlier in the report, due to the highly unusual current negative CPI indexes, staff is recommending the following components have no adjustment this year. The comparison of application of the current negative CPI index and no adjustment is provided for each component. The decreases to the components will be reconsidered when analyzing the 2010 general adjustment.

### **Components Adjusted by the CPI Less Shelter Index (Currently -2.7%)**

#### **Maintenance and Other Operating Expenses**

Information for this component specific to Santa Monica is not available.<sup>10</sup> Therefore, the Board usually adjusts this category by the most-recently reported change in the Consumer Price Index, less shelter. The March 2008 – March 2009 percent change for this index was negative 2.7%.

The maintenance expense is one of the bigger rent dollar components. The CPI index less shelter indicates costs have decreased over the past 12 months. There is no evidence that maintenance costs have decreased locally, and it is unknown how long the downward trend will continue and how dramatic it will be.

It is important that property owners provide basic and necessary maintenance services to rental units. By not decreasing this component, it is expected basic and necessary maintenance services will continue to be provided during these difficult economic times. The 2009 estimated

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<sup>10</sup> For the 2002 report, Dr. Baar obtained data from Apartment Industry Sources for the Los Angeles area for the year 2000. The data indicated the costs for maintenance and other expenses per unit ranged from \$68 - \$126. Although this information was not specific to Santa Monica, the monthly cost used by the Board at that time for this component fell within that range.

cost will remain the same as the amount used for 2008. The difference between applying the CPI index and no adjustment is shown below.

Maintenance	2008 Average Monthly Cost Per Apt. Unit	Percent Change 2008-2009	Cost Change/ Apt/Month	Estimated 2009 Cost
CPI all items less shelter Percent Change	\$112.07	-2.7%	-\$3.03	\$109.04
No adjustment	112.07	0%	\$0.00	\$112.07

### Insurance

Prior to 1997 the general adjustment report considered the insurance component together with the maintenance component. The CPI, less shelter (March to March percent change) was used to calculate the annual increase or decrease for that combined component. In 1997, the Board commissioned Thomas D. Stringer of Stringer Appraisals to prepare a report on insurance costs. Based on that report and other information gathered by the Board, the 1997 general adjustment report found an increase of 27.8% for insurance was warranted. It was necessary to separate the insurance component from the maintenance component in order to apply the increase only to the insurance cost which resulted in an average monthly cost per apartment at \$23.96. The component was again adjusted in 1998 by 4.26% based on a subsequent report by Mr. Stringer.

Since 1998, the Board has used the change in the CPI, less shelter to calculate the annual increase for this component. The effect of applying the negative 2.7% CPI, less shelter index to the insurance component would result in a cost for 2009 of \$31.08 which reflects a decrease of \$0.86 per apartment per month. As with the maintenance component, staff did not decrease the insurance component by the CPI less shelter index this year.

Comments by the public as well as some of the data reviewed by staff suggested additional analysis of local insurance costs may be warranted for next year's analysis. It is unknown whether costs for insurance for buildings in Santa Monica have risen more than the increases allowed by percentage changes of the CPI index in previous general adjustment calculations. Staff reviewed information and data from a variety of sources. Most of the available information is not specific to Santa Monica, and it is possible that the average expense information for Los Angeles might not accurately reflect changes in insurance costs for Santa Monica buildings. A summary of insurance cost information obtained is outlined in Appendix 3. Staff does not have enough information to conclude that an increase to the insurance adjustment is warranted this year. If the Board would like an in-depth analysis of insurance costs for the Santa Monica area, staff recommends the Board commission a study on this component for next year's report.

Staff made no changes to this component and is estimating the same cost for 2009 as calculated for 2008.

	2008 Average Monthly Cost Per Apt. Unit	Percent Change 2008-2009	Cost Change/ Apt./Month	Estimated 2009 Cost
<b>Insurance</b>				
<b>CPI all items less shelter</b>				
<b>Percent Change</b>	\$31.94	-2.7%	-\$0.86	\$31.08
<b>No Adjustment</b>	31.94	0.0%	0.00	31.94

**Components Adjusted by the CPI All Items Index (Currently -1.0%)**

Staff is recommending the following components have no adjustment this year. The comparison of application of the -1.0% CPI All Items and no adjustment is provided for each component. The decreases to the components will be reconsidered when analyzing the 2010 general adjustment.

**Self Labor**

	2008 Average Monthly Cost Per Apt. Unit	Percent Change 2008-2009	Cost Change/ Apt./Month	Estimated 2009 Cost
<b>Self Labor</b>	\$56.76	-1.0%	-\$0.57	\$56.19
<b>No Adjustment</b>	\$56.76	0.0%	0.00	\$56.76

**Cash Flow Adjustment**

	2008 Average Monthly Cost Per Apt. Unit	Percent Change 2008-2009	Cost Change/ Apt./Month	Estimated 2009 cost
<b>Cash Flow</b>	\$274.89	-1.0%	\$-2.75	\$272.14
<b>No Adjustment</b>	\$274.89	0.0%	0.00	\$274.89

## Management

Management costs are fixed at 5% of gross rent pursuant to Rent Board Regulation 4101(c)(1). After the adjustment is applied to this component, it is readjusted to be set at 5% of the current gross rent. The effects of either a decrease of -1.0% or no adjustment on this component are shown below.

	2008 Average Monthly Cost Per Apt. Unit	Percent Change 2008-2009	Cost Change/ Apt./Month	Estimated 2008 Cost
Management	\$39.00	-1.0%	-\$0.39	\$38.61
No Adjustment	\$39.00	0.0%	0.00	\$39.00

**Table A**

**Calculation of Annual General Adjustment  
Percentage and Dollar Amounts**

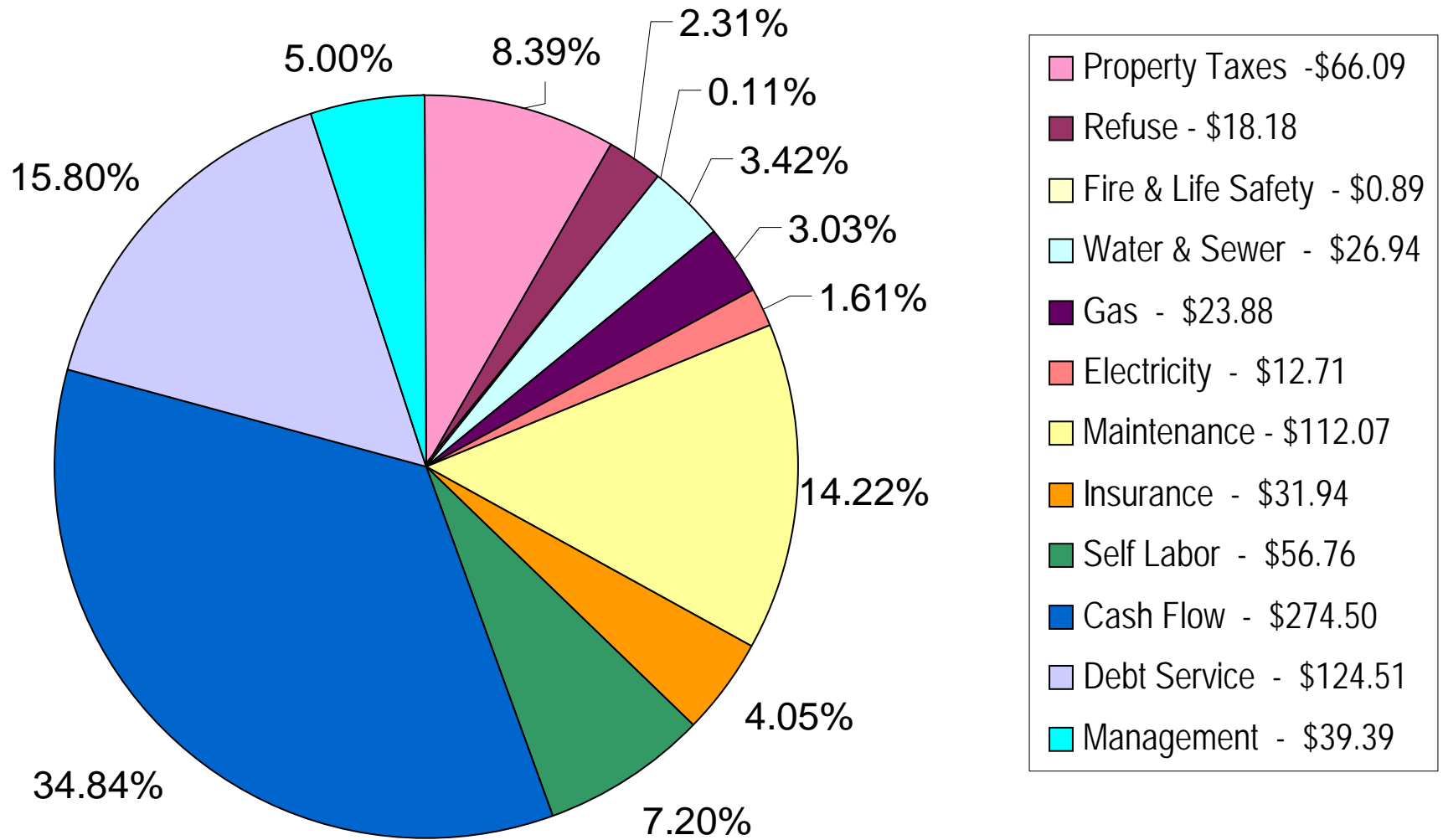
**Rent Increases Required to Cover Operating Cost Increases and Index Cash Flow**

Operating Expense	2008 ratio to gross rent (a)	Estimated cost 2008	Percent increase 2008-2009 (b)	Percent Increase Required (a) x (b)	Estimated cost 2009 (c)	Rent Adjustment required (d)
Property Taxes	0.0831	\$64.79	2.0%	0.1661%	\$66.09	\$1.30
Refuse	0.0225	17.53	3.7%	0.0832%	18.18	0.65
Fire & Life Safety Inspection Fee	0.0011	0.83	7.2%	0.0077%	0.89	0.06
Water & Sewer	0.0301	23.51	14.59%	0.4394%	26.94	3.43
Gas	0.0304	23.75	0.53%	0.0161%	23.88	0.13
Electricity	0.0134	10.46	21.49%	0.2882%	12.71	2.25
Maintenance	0.1437	112.07	0.0%	0.0000%	112.07	0.00
Insurance	0.0409	31.94	0.0%	0.0000%	31.94	0.00
Self Labor	0.0728	56.76	0.0%	0.0000%	56.76	0.00
Debt Service	0.1596	124.51	0.0%	0.0000%	124.51	0.00
Cash Flow	0.3524	274.89	0.0%	0.0000%	274.50*	-0.39*
Management	0.0500	<u>39.00</u>	0.0%	0.0000%	<u>39.39*</u>	<u>0.39*</u>
<b>Totals</b>		<b>\$780.04</b>		<b>1.0%</b>	<b>\$787.86</b>	<b>\$7.82</b>
				<b>\$780.04 x 1% =</b>	<b>\$787.84</b>	

(Due to rounding, the figures in the "Estimated cost 2009" and "Rent Adjustment required" columns result in totals that are \$0.02 more than the result of applying the 1% GA to the 2008 rent of \$780.04. The amount of \$787.84 is the figure to be used as the hypothetical average rent for 2009.)

\* Management costs are fixed at 5% of gross rent pursuant to Rent Board Regulation 4101(c)(1). Adjusting management to equal 5% of the new gross rent of \$787.84 sets the cost for management to \$39.39 rather than 39.00. Cash Flow has been adjusted slightly to reflect the increase in the management cost.

# 2009 Rent Dollar Components



## APPENDIX 1

### Methodology

In 1983, at the direction of the Board, Dr. Kenneth Baar developed a methodology for calculating the annual general adjustment. Some modifications were made to the methodology in subsequent years.

In 2002, Dr. Baar was again asked to prepare the general adjustment report for the Board. In his report, Dr. Baar analyzed various approaches to calculating the general adjustment. However, the Board decided not to alter the methodology previously developed by Dr. Baar. The Board did incorporate some of Dr. Baar's recommended modifications to several of the components based on his extensive review of the components. These modifications were incorporated in the general adjustment reports beginning in 2003.

In 2008, staff proposed an alternate methodology based entirely on the CPI index. However, the Board felt the existing methodology was most responsive to changes in costs for Santa Monica properties and did not change the methodology. The 2009 general adjustment report was prepared using the methodology and survey data previously developed by Dr. Baar. The Board continues to follow that methodology with the features shown below. For this report, staff collected data from Southern California Gas, Southern California Edison, the U.S. Bureau of Labor Statistics and the City of Santa Monica (Water Department and Solid Waste Department).

1. Division of the rent dollar into categories of expense, including "hard expenses" (taxes, utilities, City services), and "calculated expenses" (management, maintenance and other operating costs, and net operating income).
2. Identification of the "component ratio to gross rent" by dividing the dollar amount of each component of the rent dollar for the hypothetical average apartment by the total rent dollars. These ratios represent the percentage of the average rent dollar devoted to each expense category. See Table A, page 16.
3. Survey of utility companies and government agencies to determine actual increases (or decreases) in costs to property owners in the last year.

This methodology is consistent with the Rent Control Law as stated in the Board's Charter Amendment. Section 1805(b) is shown below.

(b) ANNUAL GENERAL ADJUSTMENT: Each year the Board shall generally adjust rents as follows:

- (1) Adjust rents upward by granting landlords a utility and tax increase adjustment for actual increases in the City of Santa Monica for taxes and utilities.
- (2) Adjust rents upward by granting landlords a maintenance increase adjustment for actual increases in the City of Santa Monica for maintenance expenses.
- (3) Adjust rents downward by requiring landlords to decrease rents for any actual decreases in the City of Santa Monica for taxes.

In adjusting rents under this subsection, the Board shall adopt a formula of general application.

## APPENDIX 2

### Water and Sewer

#### Water Consumption

The new rate structure is wholly dependent on the amount of water used. Therefore, consumption levels play an even more significant role than in past years in determining the average costs for water and sewer. In order to properly evaluate changes in the cost of the water/sewer component for the general adjustment, staff has been monitoring water consumption for many years. Since 1997, staff has tracked water consumption rates and water/sewer and refuse costs on two sets of randomly selected properties. (Tracking began on one set of properties in 1992.) This research has led to some modifications over the years to the average consumption rate (measured in HCF – hundred cubic feet). The 1999/2000 general adjustment report modified the average consumption rate to 4.6 HCF which reflected a reduction in consumption. Staff used 4.6 HCF as the average consumption rate until 2006. In the 2006 general adjustment report, staff found that an upward adjustment to the average consumption rate was warranted and increased the rate to 4.85 HCF.

This year, staff again reviewed the water consumption rates and costs of water/sewer for the two sets of properties. Currently, the two sets include 55 and 73 properties. Staff believes these properties provide a good representation of water consumption in controlled rental units. The table below shows the number of properties, the number of units and what percentage of each group's units is within the seven city areas defined by the Rent Control Board for various analyses. In most instances, the groups' percentages are similar to the overall distribution of controlled units within the city areas.

City Area	1 <sup>st</sup> Group 55 properties/578 units			2 <sup>nd</sup> Group 73 properties/603 units			
	% of all units by area	Number of properties	Number of units	% units in area	Number of properties	Number of units	% units in area
A	17%	11	92	15.92%	8	65	10.78%
B	12%	8	43	7.44%	5	24	3.98%
C	4%	1	42	7.27%	1	10	1.66%
D	10%	6	51	8.82%	9	58	9.62%
E	19%	14	128	22.15%	18	138	22.89%
F	16%	5	116	20.07%	8	117	19.40%
G	22%	10	109	18.34%	24	191	31.67%

In the past, staff reviewed consumption and costs for the six billing periods (twelve months) immediately preceding the issuance of the general adjustment report and compared those averages to the consumption and costs for the prior year. The new rate structure went into effect as of August 1, 2008. However, the actual date of implementation of the new rates was dependent on the billing cycle time period. Billing cycles which began on or after August 1, 2008 used the new rates (the rates were not pro-rated). If a property's billing cycle included days prior to August 1, 2008 the old rate structure was used. (Example: For a property with a billing cycle of 7/8/08 through 9/4/08, the old rate structure was used for that period and the new rates were not implemented until the following billing cycle beginning 9/4/08.) For this report, in order to more accurately reflect the effect of the new rate structure, staff reviewed consumption and costs for the three most recent billing cycles (six

months) which incorporated the new rate structure and compared it to the same three billing cycles from the prior year.

### Water Consumption Table

Year*	Average HCF used in GA	Avg. HCF 1 <sup>st</sup> Group	Avg. HCF 2 <sup>nd</sup> Group
1997	5.0	4.83	4.56
1998	5.0	4.65	4.54
1999	5.0	4.66	4.51
2000	4.6	4.65	4.34
2001	4.6	4.77	4.42
2004	4.6	5.30	4.61
2005	4.6	5.04	4.52
2006	4.85	4.96	4.68
2007	4.85	5.00	4.71
2008	4.85	4.81	4.64
2009	4.85	(old rate) (new rates) 4.62 4.79	(old rate) (new rates) 4.43 4.45

\*The study was not performed in 2002 and 2003.

In 2006, the average consumption rate used to calculate average water and sewer costs was raised from 4.6 HCF to 4.85 HCF. The average consumption for both groups rose somewhat in 2007. For 2008 the average HCFs for both groups (4.81 HCF – first group and 4.64 HCF second group) reflect a slight decrease from the consumption levels in 2006 and 2007. For 2009 the average HCF for both groups before and after the rate changes indicates consumption has continued to drop. (Once the new rates were implemented, consumption levels did increase somewhat for both groups, but still reflected a decrease from the 2008 consumption levels.)

It is difficult to project the full effect the new rate structure will have on consumption. At this time, the data continues to support the use of 4.85 HCF as the average consumption rate and the water and sewer costs projected for 2009 are based on that average. If, over the course of time, the rate of water consumption continues to decrease, staff will adjust the average consumption rate accordingly and make the necessary adjustments to the average per unit cost.

## APPENDIX 3

### Insurance

A summary of information staff obtained while researching the cost of insurance for Santa Monica is outlined below. Only the first item reflects information from Santa Monica. The middle three items are for the Los Angeles area and the final item is for California. It should be noted that the average expense information for Los Angeles may not accurately reflect changes in the cost for insurance in Santa Monica.

#### Santa Monica

- ◆ A representative of Community Corporation, a non-profit agency that owns and manages 90 buildings in Santa Monica with a total of approximately 1500 units, informed staff their records indicate 2009 insurance costs increased between 6% and 10% over costs from 2008. However, no cost information was available for prior years, or for policies to be renewed for 2009.

- ◆ During last year's general adjustment analysis, some insurance information was provided by the public. Due to the various types of insurance coverage, differences in deductibles and in amounts of coverage, staff was unable to distinguish actual changes in rates from changes in levels of coverage and other policy changes. No specific information on rate changes was provided.

#### Los Angeles

- ◆ Information from the Urban Land Institute indicated that the average monthly apartment cost for insurance in 2004 was \$23.83. The sample used in this report is for buildings with 100 or fewer units.

- ◆ Reports from the Institute of Real Estate Management (IREM) show monthly average insurance costs per unit in 2005 to be \$16.25. In 2006, the average monthly cost per apartment was \$19.91 and in 2009 the average monthly cost was \$29. This data is for "Garden Type Buildings" which typically have 100 or more units. The sample size for the smaller buildings (12-24 units and 24 + units) was too small to be considered representative of costs. In general, it appears that insurance costs for larger buildings are significantly less than costs for smaller apartment buildings.

- ◆ Reports from the Apartment Building Appraisers and Analysts indicate the monthly average insurance cost for 2005 was \$27.42. It then rose slightly to \$27.75 in 2006. In 2007, the monthly average cost was \$30.50. The average number of units in the sample of buildings used for those years ranged from 11 - 14 units.

#### California

- ◆ Information from the California Department of Insurance shows that in October 2008 State Farm received approval for a rate increase on homeowners' policies of 6.9% and Farmers Group received approval for an increase of 4.1%. Allstate subsequently received approval for an increase of 6.9%. These rate increases are for homeowner's policies and may not accurately reflect increases for commercial insurance available for owners of rental property.

Staff was unable to obtain specific information about recent changes in commercial insurance rates for either Los Angeles or Santa Monica. A State Farm representative did indicate that costs for "fire" coverage have been the same for the last 3-5 years.

The table below shows the monthly average amounts used in past general adjustment reports issued by the Board. The figures show that between 2000 and 2008 insurance costs were increased by 21.35%.

2000	2001	2002	2003	2004	2005	2006	2007	2008
\$26.22	\$27.01	\$27.31	\$28.29	\$28.35	\$29.12	\$30.31	\$30.98	\$31.94

The average cost per unit in the table shows that the amounts are in line with or higher than the monthly averages shown in the above summary for Los Angeles. This appears to indicate that no special increase adjustment is warranted. It is unknown if the costs for insurance for buildings in Santa Monica have risen more than the increases allowed by percentage changes of the CPI index. If the Board would like an in-depth analysis of insurance costs for the Santa Monica area, staff recommends the Board commission a study on this component for next year's report.