Government of the District of Columbia

Office of the Tenant Advocate

Testimony of

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Public Hearing on:
Bill 23-0873, the "Rent Stabilization Program Reform and Expansion Amendment Act of 2020"
Bill 23-0972, the "Hardship Petition Reform Amendment Act of 2020"

Committee on Housing & Neighborhood Revitalization
The Honorable Anita Bonds, Chairperson
Council of the District of Columbia

on

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Via Virtual Platform

Introduction

Good afternoon, Chairperson Bonds, members of the Committee, and staff. I am Johanna Shreve, Chief Tenant Advocate at the Office of the Tenant Advocate (OTA). Today I testify in support of Bill 23-873, the "Rent Stabilization Program Reform and Expansion Amendment Act of 2020," which would significantly strengthen and expand rent control in the District of Columbia and would do so comprehensively; and Bill 23-972, the "Hardship Petition Reform Amendment Act of 2020," which would make significant progress specifically regarding hardship petitions. I thank Councilmembers Brianne Nadeau and Trayon White for introducing the first measure, and I thank you, Chairperson Bonds, for introducing the second measure, and for convening the hearings today and a week ago to consider both measures.

The Rental Housing Act's legislative purposes juxtapose two competing yet core objectives – affordability for moderate-income and lower-income District residents, and reasonable profitability for housing providers.[1] At each renewal

[1] DC Law 6-10 § 42–3501.02. Purposes ("In enacting this chapter, the Council of the District of Columbia supports the following statutory purposes: (1) To protect low- and moderate-income tenants from the erosion of their income from increased housing costs; … and (5) To prevent the erosion of moderately priced rental housing while providing housing providers and developers with a reasonable rate of return on their investments").

cycle we hear dire predictions from some housing provider interests regarding the fate of rental housing in the District due to rent control and any efforts to strengthen rent control.

Let me be clear at the outset. I do not dismiss the reality that some landlords experience situational financial hardships. I believe some of those situations, where the housing provider has acted in good faith, may call for creative policy solutions outside of the rent control law itself. In particular, I have in mind smaller housing providers who have challenges regarding the maintenance of older rental properties. As a member of the Mayor's 2015 DC Housing Preservation Strike Force, I recommended the creation of a special fund to help small housing providers replace deteriorating building systems and make other major repairs; and indeed the Mayor incorporated a Small Building Fund in her preservation action plan in the FY 2017 budget.[2] Over the years, we have also had interesting discussions regarding the merits of carefully targeted tax credits to ameliorate financial stress in rent-controlled and non-rent controlled rental buildings alike, and regarding the treatment of rent control as an assessment factor at the D.C. Office of Tax and Revenue.

[2] https://dhcd.dc.gov/page/small-building-program

That said, the District now has almost a half century of experience with rent control. In all those years, we have yet to see evidence that, as a general matter, the District's rent-controlled properties fare poorly in terms of profitability, or that the rent control law discourages investment in the District's rental housing market. To the contrary, these same premises were squarely contradicted in two reports issued by the Urban Institute in 1988 and 1990, both commissioned by the District pursuant to the 1985 Act.[3] So far as I know, they are the only reports to date that comprehensively address the impact of rent control on the profitability of affected buildings.[4]

Specifically, the 1990 report concluded that (1) rent control's automatic rent adjustment mechanism (then just the CPI) generally keeps pace with increased operating costs; (2) the after-tax return exceeds ten percent for rent-controlled accommodations of all sizes; and (3) the difference in after-tax returns between regulated and unregulated accommodations – regardless of building size

[3] D.C. Official Code sec. 42-3502.20.

[4] "*Rent Control and the Availability of Affordable Housing in the District of Columbia: A Delicate Balance*," by Margery Austin Turner, Urban Institute, October 1988, p. 95 ("Rent control appears to have moderated the housing affordability problem, but has by no means solved it. And there is no convincing evidence that controls have significantly deterred investment in either maintenance or new construction …"; "*Housing Market Impacts of Rent Control: The Washington, D.C. Experience,*" by Margery Austin Turner, Urban Institute Report 90-1, 1990.

– is at most five percent.[5] Regarding smaller rent controlled in particular, the report concludes "*to accurately measure the profitability of investment, we need to incorporate both expected property appreciation and federal income tax benefits*;" and "*controlled rental units in the smallest properties ... provide attractive investment opportunities*" due to expected gains and favorable tax treatment.[6]

Yes, these findings are decades old. My point is, in the decades since then, I have seen no concrete data that contradicts these general findings. Moreover, at the hearing a week ago, we heard compelling testimony from an affordable housing developer (Mi Casa) that assists tenants with the TOPA process, and thus regularly reviews financial reports for rent-controlled properties. According to that testimony, these properties on average have less than 50 units, are not at risk of going into default, and mostly show positive cash flow.[7]

I will continue to engage any discussion about how to promote and maintain a favorable climate for rental housing investments in the District. However, I also firmly believe that goal is not even remotely at odds with the twin

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[5]Urban Institute Report 90-1, p. 83. In part, this statistic is based on self-reporting by housing providers as to how much an increase in revenue would be returned to investors as opposed to being used for maintenance and capital improvements.
[6] Urban Institute Report 90-1, p. 59-60.
[7] 11/9/20 Testimony of Robert Koehnke, Project Manager, Mi Casa.

goals of promoting and maintaining affordable rental housing in the District, and strengthening and expanding rent control.

What the bills do

By contrast with the available evidence regarding *profitability*, the bills before us today address a range of demonstrable *affordability* problems that have bedeviled the District's rent control program since 1985. As I noted when I testified before this Committee in September about Certificates of Assurance, then-Councilmember Hilda Mason voted "no" on the 1985 Act due to the affordability problems she so accurately predicted.[8]

Bill 23-873, the "Rent Stabilization Program Reform and Expansion Amendment Act of 2020" tackles these problems by:

1. Limiting the standard annual rent increase to the CPI only, eliminating the "plus 2 percent";

2. Right-sizing the 12 percent guaranteed rate of return under a hardship petition;

3. Eliminating the vacancy increase and voluntary agreements;

4. Preventing the unlawful preservation of rent adjustments by requiring the housing provider to "use or lose" any adjustment within 30 days after first being eligible to implement it;

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[8]*Extended Remarks of Hilda Howland M. Mason, Member At-Large, Council of the District of Columbia, To Be Entered into the Public Record of the Council's Action on Final Reading of Bill 6-33, "Rental Housing Act of 1985"* (April 30, 1985), p. 3.

5. Expanding the stock of rent control housing by applying rent control to:
    a. Buildings that have been in service for more than 15 years; and
    b. Housing providers who own four (instead of five) or more units in the District;

6. Requiring the landlord prior to filing a rent increase petition to:
    a. Establish and maintain a replacement reserve account;
    b. Call for a DCRA inspection; and
    c. Abate any housing code violations.

Bill 23-972, the "Hardship Petition Reform Amendment Act of 2020," substantially overlaps with the portions of Bill 23-873 relating to hardship petitions and the petition process generally. The bill (1) sets the guaranteed profit margin under a hardship petition to the yield of the 10-year U.S. Treasury note, averaged annually, plus two percent; (2) caps the annual hardship increase for any unit at 5 percent of rent charged; and (3) reforms the housing provider petition review process generally for all petition types.

In my testimony today, I will mainly refer to the comprehensive measure, Bill 23-873, except as noted in discussing hardship petitions.

Observations, Recommendations, and Concerns

Making rent control permanent

First, notwithstanding the Council's 10-year renewal of the rent control law in the Fiscal Year 2021 Budget Support Act of 2020, I again urge the Committee to

consider making the rent control law permanent. This is a critical step towards a truly *comprehensive* affordable housing strategy for the District. What we should have learned by now is that no other affordable housing program can provide as much housing security for the vast majority of District residents who have moderate or lower incomes – those who may not need housing subsidies, but who simply cannot afford to stay in their homes without common sense rent regulation.

The kinds of households for which rent control provides greater housing stability are prominently reflected in the District's demographics. The number of residents aged 65 years and older grew 27 percent between 2005 and 2016,[9] and as of 2019 that number was approximately 87,500[10]; 11.3 percent of the District's population has a disability[11]; and as of 2018, 52 percent of children in the District lived in single-parent households.[12] Additionally, there were approximately 106,000 households in the District with four or more members as of 2019.[13]

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[9] https://www.dcpolicycenter.org/publications/a-portrait-of-d-c-s-older-adults/

[10] https://data.census.gov/cedsci/table?q=district%20of%20columbia&g=0400000US51&y=2019&tid=ACSST1Y2019.S0103&hidePreview=true

[11] Id.

[12] https://www.dchealthmatters.org/indicators/index/view?indicatorId=411&localeId=130951

[13] https://www.census.gov/programs-surveys/ahs/data/interactive/ahstablecreator.html?s_areas=47900&s_year=2019&s_tablename=TABLE8A&s_bygroup1=1&s_bygroup2=1&s_filtergroup1=3&s_filtergroup2=1

Making rent control permanent, I believe, would help establish the program as the bedrock affordable housing tool that it already is, and would promote more comprehensive and more cohesive affordable housing strategies. Regarding Constitutionality, the OTA has considered the issue and believes that a permanent rent control law is well within the bounds of modern jurisprudence on regulatory takings, due process, and other relevant Constitutional considerations. I also note the recent ruling of a federal district court upholding New York's 2019 rent control reform law, which was made permanent in lieu of the previous triennial renewal period.[14] Nevertheless, given the potential for court challenges to a permanent rent control law, we also recommend the inclusion of a severability clause.

Replacement reserve accounts

Requiring a landlord to maintain a replacement reserve account as a condition for submitting a housing provider petition should be considered a top priority. I have steadfastly advocated for replacement reserves to be required in order to prevent landlords from using petitions to foist onto tenants what should be standard operational expenses – expenses that the landlord should have included in a budget and financial plan.

[14] *Cmty. Hous. Improvement Program v. City of New York*, 2020 WL 5819900 (E.D.N.Y. Sept. 30, 2020).

The bill would require housing providers to deposit $250 per unit, or another amount as the Mayor may determine, into such an account. I am not sure that a one-size-fits-all approach is workable. Variables may include the age of the building, anticipated short-term versus long-term expenses based on a proper reserve analysis, and outstanding repair and maintenance needs at the time the fund is capitalized. Thus, there may be a danger of over-regulation as well as under-regulation in terms of the amount and the timing of the reserve requirements. I recommend that the Committee instead allow the landlord to fund the reserve account in a manner determined through a certified reserve analysis performed by a qualified third party.

Limiting the standard annual increase to CPI only

I have long advocated for limiting the standard annual rent increase under rent control to the annual change in the CPI. The additional two percent currently allowed in addition to the CPI has an exponential compounding impact on rent levels, and contributes to the loss of affordability in the District.

I also note that as of 2018 the average annual rent increase under the District's rent control program was roughly two percent higher than the average rent increase in New York City. This remains true whether rent increases are

averaged over the past 5, 10, 15, or 20 years.[15] Thus, without the “plus two percent,” landlords in the District would be on a level playing field with landlords in New York City – a city with notoriously high costs associated with housing.

Eliminating the vacancy increase

I support the proposed elimination of the vacancy increase because (1) it is a major cause of the loss of affordability in rent-controlled accommodations, and (2) should be generally unnecessary if a sound financial plan and capital reserve account is in place. The vacancy increase is meant to cover foreseeable costs that a landlord may incur resulting from unit turnover. I believe that a permanent 10 or 20 percent rent increase to cover one-time costs neither makes good sense, nor strikes an appropriate balance between affordability and profitability. This is particularly true at university and college off-campus rentals with extremely high turnover rates. Landlords should be able to anticipate turnover costs, such as periodically replacing appliances, and fund their capital reserve accounts accordingly through rental revenue.[16]

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[15] Committee on Housing and Neighborhood Revitalization Report on Bill 22-0025 (L22-0223), the " Vacancy Increase Reform Amendment Act of 2018," November 7, 2018, page 12.

[16] Guerra v. District of Columbia Rental Hous. Comm’n., 501 A.2d 786, 789 (D.C. 1985). In disallowing a vacancy increase on the basis of just a partial vacancy in the unit, the District of Columbia Court of Appeals said that the vacancy increase is justified only where the landlord incurs actual increased costs due to the vacancy. Otherwise, the Act could be construed as providing the landlord with a windfall, which would be contrary to the Act’s statutory scheme and legislative purposes ("[t]o prevent the erosion of moderately priced rental housing while providing landlords and developers with a reasonable rate of return on their investments.”).

Eliminating voluntary agreements

As I testified before this Committee on September 24th regarding Bill 23-878, the "Voluntary Agreement Moratorium Amendment Act of 2020," it is time for the District to eliminate voluntary agreements. I support the provision in the bill to do just that. For too long, landlords have abused the voluntary agreement process. Tenants have been enticed and sometimes coerced into signing voluntary agreements approving rent increases that will not apply to them, but rather only to future tenants. That is a formula for the attrition of buildings one at a time from affordable, meaningful rent control, putting the Act truly at odds with itself.

Too often the inducement is the promise of building improvements that never materialize. Too often developers secure voluntary agreements from tenants to increase future rents even before they even have actual site control. The fact that 70 percent of tenants can obligate the remaining 30 percent of tenants has led to divisive tactics, side-deals, and inequitable outcomes. Finally, there is probably no greater cause of unaffordability in the rent-controlled housing stock than the voluntary agreement.

Expanding the District's stock of rent control housing

As has been amply commented upon, the District's stock of rent control housing has shrunk considerably over the decades. The bill would reverse this trend and expand rent control in two ways. It would limit the new construction exemption, which currently exempts buildings that went into service after 1975, to buildings that have been in service for less than 15 years. And it would limit the small landlord exemption, which currently exempts landlords who own fewer than five units in the District, to landlords who own fewer than four units in the District.

Some ask why expand rent control to include units that may already be categorized as unaffordable? Here is why. Consider a two-income household consisting of a teacher and a firefighter, or a teacher and a police officer, or a teacher and an administrative worker. Let's suppose that each tenant makes at least $54,000 per year after taxes, and the rent for their one or two bedroom apartment is $2,700. Thirty percent or less of the total household income is needed to pay the rent, so that unit is in fact affordable for them. Without rent stabilization, however, rent increases could easily make that unit unaffordable. Indeed from our experience a rent increase of $500 or $700 is not uncommon.

We want these families to be able to live and thrive in the District of Columbia. That is why rent control reform and expansion is so important.

Housing provider petitions generally

Housing provider petitions have resulted in the loss of affordable rental units, unfair and exorbitant rent increases, and the displacement of tenants. Both bills commendably address various loopholes and deficiencies in the current housing provider petition process. Housing provider petitions serve particular purposes and are meant to help landlords who, for one reason or another, require additional funds to keep their housing accommodations safe and sanitary. Establishing greater rationality and predictability in the petition process will help keep more rental units affordable, and it will help ensure that tenants are not unfairly impacted in the process.

Selective implementation

Selective implementation of approved rent adjustments is an example. Often, the landlord will strategically impose approved surcharges only on some units, almost always on units with lower rents. The goal may include marketing vacant apartments for rent, and evening rent levels between longer-term residents and new residents. Because the landlord is entitled to full recovery of

the aggregate amount of the approved surcharges, these longer-term tenants are then required to pay the surcharge over a longer period of time. Thus, "selective implementation" defeats the statutory scheme of equitable assessments to avoid only some tenants having to bear the brunt of the increase.

Regarding capital improvements and substantial rehabilitations, both bills address this practice by clarifying that landlords cannot continue to impose a surcharge or request an extension after the expiration of the recovery period, where the lack of full cost recovery is due to the *landlord's own choice* to selectively implement the surcharges. I have long advocated for and fully support this solution to the problem. Regarding hardship petitions, however, I will recommend later in my testimony an adjustment to the relevant language.

Rent surcharges that are temporary and cannot be preserved

I support the proposal to change all petition rent increases, except for services and facilities petitions, to temporary rent surcharges. I also support the explicit "use or lose" provision whereby the landlord forfeits an approved adjustment unless used within 30 days of first being eligible to do so. Too many landlords hold onto approved adjustments and wait for the market to present the most opportune moment to impose the rent surcharge on tenants. For the

tenant, this often presents unpredictable “sticker shock” rent increases. It is an end-run of the Council’s abolition of rent ceilings in 2006 and should not be allowed.

Housing code compliance as a condition for petition approval

As I have testified previously before this Committee, landlords should not be permitted to allow their properties to fall into disrepair and then pass the associated costs to their tenants via either a rent increase or surcharge. The availability of petitions should not be an excuse for deferred maintenance or poor management practices. Requiring that landlords abate all substantial code violations and have all rental units and common areas inspected for housing code violations no more than 30 days prior to filing a petition will hopefully discourage irresponsible practices and encourage landlord compliance.

It should be noted however, that there is a common-sense exception to this requirement - substantial rehabilitation petitions. The purpose of the substantial rehabilitation petition is to address buildings that are in such poor condition that rampant housing code violations cannot be abated but for the corresponding surcharge. Therefore, the Committee should exclude the substantial rehabilitation

petition from the requirement of prior housing code abatement as a condition to file for a petition.

Rent Administrator oversight and timeframes

I have always advocated that tenants and stakeholders should be permitted to realistically deliberate upon and present their objections to a petition, and I therefore applaud the provision that would extend the time for tenants to do so. However, I do not believe based upon our experience with tenants that the extension from 15 to 30 days provided in the bill is sufficient for tenants to adequately prepare to undertake the process of opposing a petition. Often the first step tenants must take is to form a tenant association. This takes considerable time including organizing tenants, electing officers, creating bylaws, and then filing with DCRA's Office of Corporations – all before finally getting to the business of considering the petition itself.

Therefore, I recommend that the Committee extend the timeframe for filing objections, taking into account whether or not there is an existing tenant association at the housing accommodation in question. If there is no such tenant association, tenants should have 120 days to organize, form an association, hire experts, and draft their objections. If there is a tenant association, the timeline

should be extended to 60 days. By doing this, we would afford tenants with a more realistic timeframe that considers all the necessary steps that must be taken to formally submit effective objections to a landlord's petition.

I also fully support the provision in both bills that (1) empowers the Rent Administrator to require that landlords provide an independent audit of books and records to prove the need for a larger rent increase; and (2) authorizes intervention by the Office of the Attorney General in a petition proceeding. These provisions will incentivize honest dealing by landlords who file these petitions.

Rent Administrator standard operating procedure

Lastly, I urge the Committee to consider requiring that the Rent Administrator draft and publish standard operating procedures that are sufficiently precise so that landlords, tenants, and future Rent Administrators fully understand the steps required of them in the petition process. This would help tenants, and indeed all parties, engage the process efficiently and knowledgeably. I note that the existing DHCD / RAD Rent Control Fact Sheet, which includes a section on housing provider petitions, would be a good document to build upon.

Hardship petitions

As there is substantial overlap between Bill 23-873 and Bill 23-972 pertaining to hardship petitions and petitions in general, I would recommend that they be reconciled subject to the following recommendations.

Guaranteed profit margin

I have long maintained that the 12 percent guaranteed rate of return on a landlord's equity in a rental property for hardship petitions is arbitrary and excessive. The 12 percent figure was introduced into the District's rent control law in 1985, following hardship rates of 8 and 10 percent in preceding rent control laws. It was justified on the basis of a historically high – indeed a historical outlier – rate of inflation. It was bad policy then and it is deplorable policy now.

The 10-year U.S. Treasury note (T-note) is a common benchmark for other interest rates and is a more accurate indicator of current economic conditions.[17] That said, however, I note that over the last ten years the T-note rate of return has fallen from just shy of four percent to less than one percent since March of this year.[18] The 2019 annual average was 2.19 percent.[19] I recommend that the

[17] https://www.investopedia.com/terms/1/10-yeartreasury.asp
[18] https://www.macrotrends.net/2016/10-year-treasury-bond-rate-yield-chart

Committee be mindful of possible Constitutional challenges, and consider whether there should be a floor below which the guaranteed return will not fall. If so, based on the history of the guarantee, I believe 5 percent is an appropriate floor.

Duration of hardship

Because a housing provider hardship may well be legitimate but temporary, I support making an approved hardship surcharge temporary and reviewable after a three-year period. Hardship increases that last in perpetuity, as they do under the current law, become a windfall for landlords and too often are unaffordable for the tenant. Indeed, a high surcharge can be unaffordable for some tenants even in the first year it is imposed. Thus, I recommend that the Committee consider requiring hardship petitions to be reviewed every two years rather than every three.

Selective implementation: criteria for extending surcharges

As I previously noted, the language regarding selective implementation in the hardship context is problematic. Landlords submit hardship petitions not to recover necessary expenses such as they do in the context of a capital

[19] https://www.google.com/search?client=firefox-b-1-d&q=2019+10+year+treasury+rate

improvement or substantial rehabilitation, but rather to secure the guaranteed profit margin. The hardship petition surcharge serves to temporarily increase the landlord's profit margin when it has fallen below the statutorily established rate of return over a twelve-month period.

Both bills erroneously provide that the surcharge can be extended if the landlord "has not recovered the surcharge." I recommend that the Committee amend this language to permit an extension (1) only where the landlord affirmatively demonstrates that rental revenue continues to fall short of the guarantee; and (2) for a maximum of three years at a time.

I note that the possible argument that the bill is at cross-purposes with itself inasmuch as it would limit hardship petitions at the same time the replacement reserve requirement could increase the need for them. My response is that a $250 annual reserve deposit for a unit with a monthly rent of just $1,000 is only two percent of the annual rent for that unit – and that percentage falls as the rent level rises.

<u>Conclusion</u>

I wish to conclude by saying that while I have advocated and continue to advocate for an omnibus approach to rent control reform, I do not believe in an

"all or nothing" approach if that means nothing. We have long needed many of the affordability protections in these measures, and I urge the Committee and the Council to act this year. I thank you again, Chairperson Bonds, for holding this hearing and for your continued attention to these critical matters. That concludes my testimony, and I welcome questions you may have.