

**CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST**

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Policy Analysis Report

To: Supervisor Fewer
From: Budget and Legislative Analyst's Office
Re: Rental Passthrough Petitions
Date: January 27, 2020



SUMMARY OF REQUESTED ACTION

Your office requested that the Budget and Legislative Analyst provide a report to examine the frequency, conditions, and impacts of landlord petitions, passthroughs, and other expenses that result in rent increases for San Francisco tenants, as well as deferral and non-payment of passthroughs due to tenant financial hardships. Your office also requested that we examine the “evidence of reasonable reliance” requirement that applies to landlords requesting Operating and Maintenance rent increases for debt service and property tax payments.

For further information about this report, contact Fred Brousseau, Director of Policy Analysis at the Budget and Legislative Analyst's Office.

Executive Summary

- San Francisco rent control laws allow landlords to pass through at least a portion of various costs to tenants beyond the annual allowable increase of 60 percent of the Consumer Price Index for All Urban Consumers in the San Francisco Bay Area (CPI). There are five categories of expenses that may be passed on to tenants: capital improvements, operating and maintenance (O&M), general obligation bonds, utilities, and water bonds. Tenants may avoid paying capital improvement, O&M, utility, and water bond passthroughs due to financial hardship. An ordinance approved in October 2019 created a hardship provision for passthroughs of general obligation bonds approved by voters on or after November 5, 2019.
- If approved by the Rent Board, capital improvement petitions filed by landlords may pass through an amount up to five or ten percent of a tenant's base rent per year, depending on the building size and type of work. O&M petitions may increase a tenant's base rent by up to seven percent, once every five years. However, there is no overall cap for the total amount of passthroughs that may be imposed on tenants.
- Assembly Bill 1482 (AB 1482), signed into law in October 2019, sets rent caps statewide at five percent plus the rate of inflation, with certain exceptions, though it allows for cities that have them to maintain their own more restrictive rent control laws. In San Francisco, this means that current Rent Stabilization Ordinance limitations on rent increases would remain in place for residential buildings

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constructed before June 1979, but AB 1482 would apply to residential buildings constructed after that, but not within the past 15 years. However, as a State law, the Rent Board reports it does not have the authority to enforce AB 1482 limitations if they apply to rental passthroughs allowed under the local rent ordinance.

- In FY 2018-19, there were 513 petitions (comprising 3,672 units) for capital improvement passthroughs, 27 petitions (comprising 332 units) for O&M passthroughs, 31 petitions (comprising 449 units) and 147 worksheets (comprising 1,305 units) for utility passthroughs, and 239 hardship applications. Exhibit A presents this caseload for FYs 2018-19 and 2017-18

**Exhibit A: Frequency of Passthrough Petition, Worksheet, and Hardship
 Application Filings, July 2017- June 2019**

Category	FY 2017-18		FY 2018-19		Total	Total
	Filings	Units	Filings	Units	Filings	Units
Capital Improvement Petitions	490	4,416	513	3,672	1,003	8,088
Operating & Maintenance Petitions	100	1,083	27	332	127	1,415
Utility Petitions	48	522	31	449	79	971
Utility Worksheets ¹	156	1,497	147	1,305	303	2,802
Total Petitions	794	7,518	718	5,758	1,512	13,276
Hardship Applications	218	218	239	239	457	457

Source: Rent Board annual reports

¹ Worksheets are required instead of petitions in circumstances such as annually updating a landlord's utility costs in instances when a utility passthrough has already been approved pursuant to a petition approved by the Rent Board.

- We reviewed a random sample of 44 capital improvement passthrough decisions, comprising 266 units. In our sample, tenants with a passthrough approved experienced rental increases of 3.5 percent, or more than the base increase allowed for all tenants subject to the City's Rent Stabilization ordinance (sixty percent of the consumer price index for the year). When multiple passthroughs were allowed to be imposed in a single year, the percentage increase in tenant rent was as high as 13.3 percent in our sample, as detailed below:
 - The average unit in the sample had base rent of \$1,559.59 and a passthrough amount of \$54.06, or 3.5 percent of base rent.
 - 24 units, or nine percent of the sample units, were also paying other capital improvement passthroughs from prior years. These units had an

average base rent of \$1,788.31 and an average total passthrough amount of \$129.77, or 7.3 percent of base rent.

- 44 units, or 16.5 percent of the sample units, had an accumulated passthrough that could be assessed at a later date. These units had an average base rent of \$1,209.58 and an average total passthrough amount of \$95.21, or 7.9 percent of base rent.
- Eight units, or three percent of the sample units, had both a passthrough from a prior year and an accumulated passthrough. These units had an average base rent of \$1,442.41 and an average total passthrough amount of \$191.44, or 13.3 percent of base rent.
- We found 21 properties where the landlord had filed both a capital improvement and O&M petition over the two-year period of FY 2017-18 and FY 2018-19. These 21 properties are 2.5 percent of the 841 properties that had filed capital improvement petitions over the two-year period, and 16.5 percent of the 127 properties that filed O&M petitions.
- We reviewed 260 hardship applications that were decided from July 2017 through August 2019. Of these 260 applications, 243 (93.5 percent) were approved, eight (3.1 percent) were partially approved, and nine (3.5 percent) were denied.
- The average tenant applying for a financial hardship passthrough exemption had base rent of \$1,052.90 and was assessed total passthroughs of \$65.76, or 6.2 percent of base rent.
- The 2018 ordinance prohibiting property tax and debt service passthroughs allowed these increases to be considered in cases where the O&M petition was filed on or after December 11, 2017 and the property was purchased on or before April 3, 2018 if the landlord demonstrates that they reasonably relied on the ability to pass through property tax and debt service costs at the time of purchase.
- As of October 2019, the Rent Board had 30 pending O&M petitions under the reasonable reliance provision. At least one landlord with multiple properties in the City announced that they would not be pursuing these passthroughs in October 2019.
- San Francisco's rent stabilization ordinance allows landlords to impose the allowable annual increase of 60 percent of CPI. If the landlord does not impose the full allowable increase each year, the landlord may impose skipped increases at a later date. These are known as banked increases. There is no limit to the amount of increases that can be banked since April 1, 1982. There is also no time limit for imposing banked amounts.

Policy Options

1. The Board of Supervisors may consider instituting an overall, total cap on rental passthroughs. Unless AB 1482 is interpreted to cover passthroughs, there is no total cap on passthrough-based increases. A total cap would assist tenants who have been assessed multiple types of passthroughs at the same time.
2. The Board of Supervisors may consider expanding the eligibility requirements for hardship qualification. To qualify for hardship based on income, a tenant must demonstrate that their monthly rent is greater than 33 percent of their gross income and that their gross income is less than 80 percent of area median income (AMI). The Board of Supervisors may consider modifying these parameters, such as allowing tenants to qualify for hardship if monthly rent is greater than 30 percent of the tenant's gross income or if the tenant's gross income is less than 90 percent of AMI.
3. The Board of Supervisors may consider placing limits on banked rent increases, such as creating a limit on the amount that could be imposed at one time or a time limit on imposing banked amounts.

Project staff: Reuben Holober, Fred Brousseau

Rental Passthroughs

Overview of Passthroughs

San Francisco rent control laws allow landlords to pass through at least a portion of various costs to tenants beyond the annual allowable increase of 60 percent of the Consumer Price Index for All Urban Consumers in the San Francisco Bay Area (CPI). There are five categories of expenses that may be passed on to tenants: 1) capital improvements, 2) operating and maintenance, 3) general obligation bonds, 4) utilities, and 5) water bonds.

Passthrough Frequency

As shown in Exhibit 1, the most frequent type of passthrough petition is for capital improvements. Over the two-year period from July 2017 through June 2019 (FYs 2017-18 and 2018-19), there were 1,003 capital improvement petitions filed (representing 8,088 units), 127 O&M petitions (1,415 units), 79 utility petitions (971 units), and 303 utility worksheets¹ (2,802 units). As landlords are not required to file petitions for water bond or general obligation bond passthroughs (unless when challenged by a tenant), the Rent Board does not have data on the number of general obligation passthroughs imposed.

With a new ordinance adopted by the Board of Supervisors in June 2018 prohibiting debt service and property tax payments from being passed through to tenants, the number of O&M petitions filed dropped from 100 (representing 1,083 units) in FY 2017-18 to 27 (representing 332 units) in FY 2018-19. As most of the larger O&M costs had been for debt service and property tax payments prior to adoption of the ordinance in June 2018, the volume and scope of O&M petitions will likely remain limited.

Over the two-year period, a total of 457 hardship applications were filed, also shown in Exhibit 1.

¹ Worksheets are required instead of petitions in circumstances such as annually updating a landlord's utility costs in instances when a utility passthrough has already been approved pursuant to a petition approved by the Rent Board.

**Exhibit 1: Frequency of Passthrough Petition, Worksheet, and Hardship
 Application Filings, July 2017- June 2019**

Category	FY 2017-18		FY 2018-19		Total	Total
	Filings	Units	Filings	Units	Filings	Units
Capital Improvement Petitions	490	4,416	513	3,672	1,003	8,088
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Source: Rent Board annual reports.

¹ Worksheets are required instead of petitions in circumstances such as annually updating a landlord’s utility costs in instances when a utility passthrough has already been approved pursuant to a petition approved by the Rent Board.

The number of petitions filed over the past 10 years is shown in Exhibit 2 below. As can be seen, capital improvement petitions continually increased during the ten-year period, from a low of 134 in FY 2009-10 (representing 629 rental units) to 512 in FY 2018-19 (representing 3,674 units). O&M petitions increased through FY 2017-2018 (the year the ordinance was adopted prohibiting inclusion of property tax and debt service cost increases from being included in O&M passthroughs) and utility petitions and worksheets showed no clear trend.

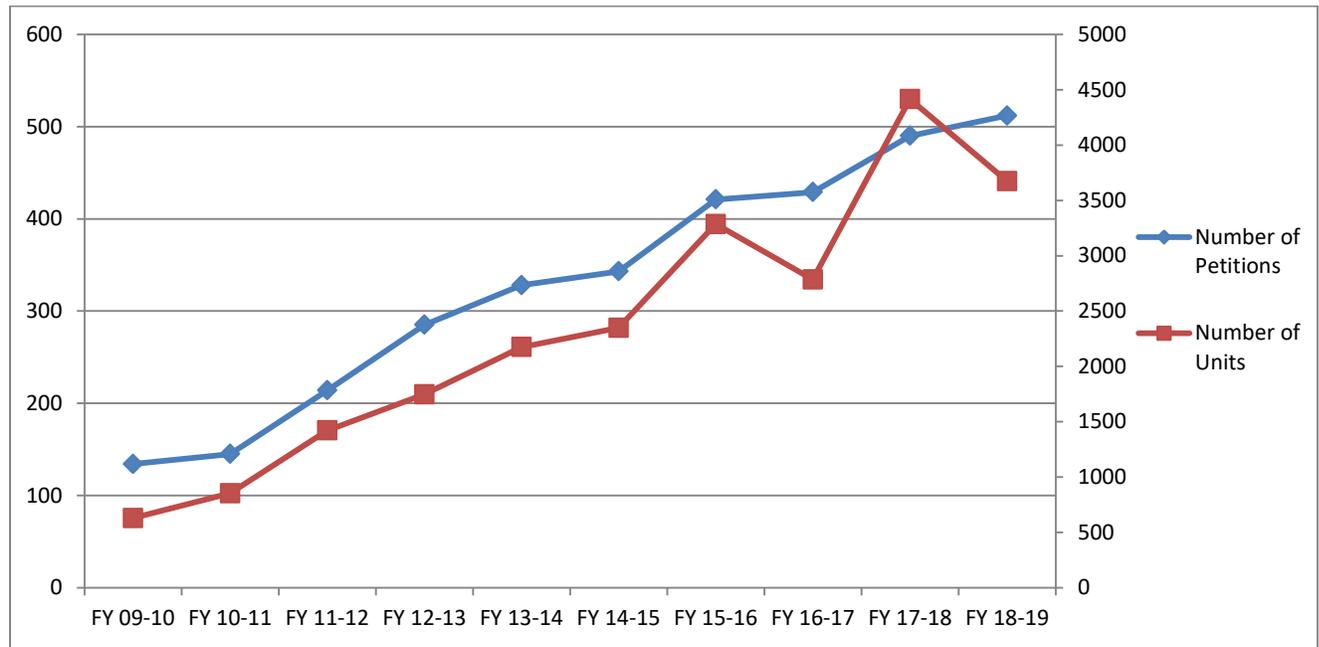
Exhibit 2: 10-Year Passthrough Petition Filing Trends

	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	Total
Capital Improvement											
Petitions	134	145	214	285	328	343	421	429	490	513	3,302
Units	629	852	1,421	1,747	2,174	2,348	3,286	2,785	4,416	3,672	23,330
O&M											
Petitions	12	20	25	46	40	45	73	77	100	27	465
Units	131	113	171	313	375	510	905	784	1,083	332	4,717
Utility Petitions											
Petitions	76	8	34	21	23	49	67	21	48	31	378
Units	1,891	372	255	115	155	306	834	145	522	449	5,044
Utility Worksheets											
Petitions	171	46	48	95	60	96	233	79	156	147	1,131
Units	651	126	475	1,092	384	491	1,830	518	1,497	1,305	8,369
Total											
Petitions	393	219	321	447	451	533	794	606	794	718	5,276
Units	3,302	1,463	2,322	3,267	3,088	3,655	6,855	4,232	7,518	5,758	41,460

Source: Rent Board annual reports

Exhibit 3 presents the trends in graphical form for capital improvement petitions for the same ten-year period.

Exhibit 3: Capital Improvement Petitions Filed to the Rent Board by Year, Fiscal Years 2009-10 through 2018-19



Source: Rent Board annual reports

While petitions have been increasing in recent years, the total number of rental units that received new passthroughs in FY 2018-19 is relatively low compared to the approximately 172,394 rent stabilized units in San Francisco. Less than 3.6 percent of all rent stabilized units were petitioned in FY 2018-19 for any type of passthrough.²

1. Capital Improvement Passthroughs

Landlords may pass along the costs of capital improvements that add value to the property. A petition must be filed with the Rent Board. Passthroughs remain in place until the landlords' costs are fully amortized, which may take several years.

² The actual percentage of rent stabilized units that were petitioned for any type of passthrough is unknown, but less than 3.6 percent, as some units were petitioned for multiple passthroughs in the same year.

For properties with 1-5 units, landlords may pass through 100 percent of costs though the passthrough amount may not exceed the greater of \$30 per month or 5% of base rent each year. This type of passthrough lasts as long as needed for the landlord to recover their total costs.

For properties with 6 or more units, landlords may pass through only 50 percent of costs. The passthrough amount may not exceed the greater of \$30 or 10 percent of base rent each year.³ This type of passthrough lasts as long as needed for the landlord to recover 50 percent of their total costs.

For seismic work and other work required by law after November 14, 2002, landlords may pass through 100 percent of costs. The passthrough amount may not exceed the greater of \$30 or 10 percent of base rent each year.

For energy conservation work, landlords may pass through 100 percent of costs, with no annual limit.⁴

2. Operating and Maintenance Passthroughs

Landlords may pass through at least a portion of operating and maintenance (O&M) costs to tenants if they are not covered by the allowable increase of 60 percent of CPI. Until June 2018, eligible O&M passthrough costs included property tax, debt service or mortgage, repairs, maintenance, insurance, pest control, garbage, water/sewer, janitorial service, elevator service, security system, reasonable and necessary management expenses, and the portion of increased property taxes resulting from the completion of needed repairs or capital improvements. An ordinance approved by the Board of Supervisors on June 5, 2018 prohibits property tax and debt service passthroughs, with limited exceptions.⁵ An analysis completed by the Budget and Legislative

³ Tenants in these properties may elect an alternative passthrough method, based on 100% of capital improvement costs, imposed at a rate of 5% of the tenant's base rent per year, with a total passthrough cap of 15% of the tenant's base rent. Since 2004, only 10 tenants have elected to use this method.

⁴ General capital improvements, seismic work and other work required by law, and energy conservation work are each considered separate categories of capital improvements. Theoretically, a tenant could receive a passthrough of 5 or 10% of base rent for general improvements, a passthrough of 10% of base rent for seismic work and work required by law, and an unlimited passthrough for energy conservation work, all in the same year.

⁵ Where the O&M petition was filed on or after December 11, 2017 and the property was purchased on or before April 3, 2018, property tax and debt service increases will be considered if the landlord demonstrates that it reasonably relied on the ability to pass through property tax and debt service costs at the time of purchase. For properties purchased after April 3, 2018, property tax or debt service costs will not be considered. However, property tax increases resulting from a reassessment due to completion of needed repairs or capital improvements may always be considered.

Analyst in 2018 showed that nearly all of the eligible costs in the petitions for O&M passthroughs decided on by the Rent Board for the twelve month period prior to adoption of this ordinance were for property tax and debt service costs.

Landlords must file a petition for approval by the Rent Board for O&M passthroughs. The passthrough may increase base rent by up to 7 percent, which becomes a permanent increase in all buildings regardless of the number of units. However, for buildings with six or more units, landlords may impose O&M passthroughs approved by the Rent Board only once every five years, whereas in buildings with fewer than six units, landlords may impose an O&M passthrough that increases the rent by up to 7 percent every year if approved by the Rent Board.

3. General Obligation Bonds

Landlords may pass through their property tax increases resulting from the repayment of voter approved general obligation bonds, as follows:

- 100 percent of the property tax increase resulting from City and County of San Francisco general obligation bonds approved between November 1996 and November 1998, distributed proportionately among all housing units in a building or complex;
- 50 percent of the property tax increase from City and County of San Francisco general obligation bonds approved after November 14, 2002; and
- 50 percent of the property tax increase from San Francisco Unified School District and San Francisco Community College District general obligation bonds approved since November 2006.

General obligation bonds approved between November 30, 1998 and November 14, 2002 are not eligible for passthrough because of Proposition H, approved by voters in 2000, which required bond passthroughs to tenants to be disclosed and approved by voters. After litigation, legislation was passed to allow general obligation bonds approved on November 15, 2002 or after to be passed through to tenants. Each year, the Controller's Office determines the overall passthrough rate after reviewing the full portfolio of general obligation bonds and this amount is distributed to all property owners. For FY 2019-20, the allowable passthrough rate is \$0.066 per \$100 of assessed value.

Under the City's previous Rent Ordinance, landlords could impose general obligation bond passthroughs from an unlimited number of prior years, dating back to November 1996, if they had not been previously imposed on their tenants and provided that their tenants resided at the subject property for which the passthrough was imposed. Under amendments to the Rent Ordinance approved by the Board of Supervisors in October 2019, landlords may now impose general obligation bond passthroughs from only a maximum of the three years prior to when the passthrough is imposed. This change will relieve tenants of potentially large, one-time rent increases in situations where multiple prior years of general obligation bond repayment costs were imposed at the same time under the terms of the prior Rent Ordinance.

Under the amended ordinance, tenant payments will now be spread over the same amount of time the passthrough covers, up to the maximum of three prior years. For example, if a landlord imposes a passthrough in 2025, it could cover up to the three preceding tax years, from 2022 through 2024, and the tenant would pay it back by 2028. This provision is effective January 1, 2021, giving landlords one year to impose uncollected general obligation bond passthroughs from prior years.

4. Utility Passthroughs

Landlords may pass through increases in utility costs to tenants, with no limit. The passthrough is based on the increase in utility costs, compared to a base year. A petition is filed for the initial passthrough and lasts for five years, although the passthrough itself lasts for only one year.

After an initial utility passthrough petition is filed with and approved by the Rent Board, utility passthrough worksheets may be filed in up to four subsequent years that document the level of increase, which then may be passed through to tenants without further Rent Board approval. After five years, a new petition is required to continue utility passthroughs.

5. Water Bonds

Landlords may pass through 50 percent of water bill charges resulting from water bonds authorized by Proposition A in the November 2002 election. The eligible passthrough amount has been specified on water bills since July 2005.

Impact of AB 1482

On October 8, 2019, Governor Gavin Newsom signed Assembly Bill 1482 (AB 1482) into law. AB 1482 caps annual rent increases statewide at five percent, plus the rate of inflation, with certain exceptions. While the law allows cities like San Francisco to maintain more restrictive local rent control ordinances, it will place rent caps on San Francisco apartments built after 1979, which are not covered by the City's Rent Stabilization Ordinance price controls, but not within the past 15 years, with the date on a rolling basis.⁶ The law will expire in 2030 if not extended. The Rent Board plans to send courtesy letters to landlords suspected of violating AB 1482 limitations, but does not have the authority to enforce the law since the Rent Board is only authorized by City law to enforce the City's rental price controls on San Francisco residential buildings constructed before June 1979. Buildings constructed after that are not subject to the City's Rent Stabilization Ordinance price controls administered by the Rent Board.

Enforcement of AB 1482 requirements would occur through the court system. A lingering question remains of whether or not the law will apply to rental passthroughs. The language of the legislation is ambiguous and will likely need to be clarified through future legislation. As a state law, the Rent Board reports it would be unable to enforce AB 1482 limitations if they were to apply to rental passthroughs allowed under the local rent ordinance.

Properties that are covered by AB 1482 limitations but exempt from San Francisco's rental price controls, such as those apartments built after 1979 but not within the past 15 years, would lack any legal provision under the new law for imposing rental passthroughs. Landlords would be unable to increase rent beyond AB 1482 annual limitations of five percent plus the rate of inflation, regardless of capital improvements, bond measures, or other landlord expenses.

Tenant Hardship Applications

Tenants may avoid paying capital improvement passthroughs, O&M rent increases, utility passthroughs, and water bond passthroughs due to financial hardship. Until October 2019, there was no hardship provision for general

⁶ On January 1, 2020, the law will apply to buildings built on or before January 1, 2005. On January 2, 2020, the law will apply to buildings built on or before January 2, 2005. The 15-year window continues on a rolling basis.

obligation bond passthroughs. A new ordinance approved in October 2019 created a hardship waiver for general obligation bonds approved by voters on or after November 5, 2019. To prove hardship, tenants must meet one of the following criteria:

1. All adults in the household receive means-tested public assistance, such as Social Security Supplemental Security Income (SSI), General Assistance (GA), Personal Assisted Employment Services (PAES), CalFresh (SNAP/food stamps), or California Work Opportunity & Responsibility to Kids (CalWORKS);
2. (a) The tenant's monthly rent is greater than 33 percent of the tenant's gross monthly household income⁷; and (b) the tenant's liquid assets do not exceed the asset amounts permitted by the Mayor's Office of Housing to determine eligibility for below market rent (BMR) home ownership; and (c) the tenant's gross monthly income is less than 80 percent of Area Median Income (AMI); or
3. The tenant has exceptional circumstances that make the rent increase a hardship, such as excessive medical bills.

After a hardship application and supporting documentation is filed by a tenant, a copy is sent to the landlord, who has 15 days to request a hearing to challenge the tenant's eligibility claim. If the landlord does not contest the application, an administrative law judge determines whether a hearing is required to obtain additional evidence or if the case can be decided without a hearing.

Capital Improvement Petitions

Sample Passthrough Petitions Reviewed

As capital improvement passthroughs make up the largest number of petitions, especially with the recent reduction in O&M petitions, we reviewed a random sample of 50 capital improvement petitions from FY 2017-18, as these were more likely to have been decided by the Rent Board at this time and we could thus review the entire case and outcome. Of the 50 petitions, 46 had been decided. Of these 46 petitions, two were removed

⁷ Gross monthly household income is defined as the total income of all adults in the unit, except for subtenants (although the rent paid by a subtenant to a tenant is considered the tenant's income).

because they did not provide base rent and had large numbers of units that would have skewed the sample.⁸ This left 44 petitions, representing 266 units, for our sample.

As can be seen in the information below about our sample cases, capital improvement passthroughs on average resulted in rent increases ranging from 3.5 percent to 13.3 percent, or well above the 2.2 and 1.6 percent rates of increase allowed for housing units under the terms of the City's Rent Control ordinance for those years. As shown, when new capital improvement passthroughs were combined with previously approved and/or accumulated passthroughs, they had higher average increases in rent than units that had a single passthrough added to their rent.

The City's Rent Ordinance allows for higher rates of increase in rent when multiple capital improvement passthroughs have been approved for the same properties. This includes both previously approved capital improvement passthroughs and "accumulated" capital improvement passthroughs, which are approved passthroughs that, if imposed, would result in a rent increase of more than the maximum allowed five or ten percent of rent depending on whether the tenants are in a building of six units or more or less than six units, respectively. However, these accumulated capital improvement amounts can be added in the next or any subsequent year, as long as they do not exceed the annual rent increase caps of five or ten percent described above.

As shown in Exhibit 4, the average unit in our sample of 44 petitions had a base rent of \$1,559.59 and an average passthrough amount of \$54.06, or 3.5 percent of base rent.⁹ The median unit had a base rent of \$1,431.79 and a median passthrough amount of \$55.26, or 3.9 percent of base rent (this information is not presented in Exhibit 4). Passthrough amounts ranged significantly, from a low of \$4.31 to a high of \$214.29.

⁸ One of these petitions was for a property with 86 units and an average passthrough of \$7.04, and the other petition was for a property with 515 units and an average passthrough of \$125.19.

⁹ For some properties, multiple capital improvement petitions were filed. If two or more petitions were filed for the same unit within the same year, they were counted as one petition and the passthrough amount is cumulative of all passthroughs

Exhibit 4: Passthroughs approved from sample of 44 petitions filed

July 2017- June 2019

	Base Rent	Units	Average Passthrough	% Increase in Base Rent	Average other¹⁰ passthrough	% Increase in Base Rent	Increase in base rent for all approved passthroughs	Cumulative % Increase in Base Rent
All units in sample of 44	\$1,559.59	266	\$54.06	3.5%	\$6.07	0.4%	\$60.13	3.9%
Units already paying a previously approved capital improvement passthrough	\$1,788.31	24	\$81.44	4.6%	\$48.34	2.7%	\$129.77	7.3%
Units with “accumulated passthrough”*	\$1,209.58	44	\$71.94	6.0%	\$23.28	1.9%	\$95.21	7.9%
Units with previously approved capital improvement passthrough + “accumulated passthrough”*	\$1,442.41	8	\$120.17	8.3%	\$71.27	4.9%	\$191.44	13.3%

Source: Rent Board petitions

* Accumulated passthroughs are amounts that may be assessed to tenants at a later time. In some cases, the accumulated passthrough was a minor correction to the amount the landlord had filed in the petition, such as an accumulated passthrough of \$0.04 that could be assessed at any time. In other cases, the amount eligible for passthrough exceeds the five or 10 percent limit of base rent that can be assessed per year. In these cases, the accumulated passthrough could be assessed one year later, even if it exceeds the five or 10 percent limit of base rent.

Of the 266 units in the sample, 24, or nine percent, were already paying a capital improvement passthrough that had been assessed in a prior year. Within this group, the average unit had a base rent of \$1,788.31, an average passthrough amount of \$81.44 on the current passthrough approved, or 4.6 percent of base rent, and an average prior passthrough of \$42.03, or 2.4 percent of base rent. These units had average total passthrough amounts of \$129.77, or 7.3 percent of base rent.

Of the 266 units in the sample, 44, or 16.5 percent, also had an “accumulated passthrough” that could be assessed as soon as the next year (or later if the

¹⁰ In this table, an “other passthrough” is the combined amount of passthroughs assessed to the tenant in prior years and accumulated passthroughs that may be assessed to the tenant in a future year.

landlord prefers).¹¹ Accumulated passthroughs are landlord costs for capital improvements included in their petitions that, if imposed on the tenants, would exceed the five or 10 percent limit of base rent that can be assessed per year. In these cases, the accumulated passthrough amounts can be assessed one year later, even if the rent increase then exceeds the five or 10 percent limit of base rent. Within this group, the average unit had a base rent of \$1,209.58, and average passthrough amount of \$71.94, or six percent of base rent, and an average accumulated passthrough of \$13.76, or 1.1 percent of base rent. Tenants in this sample have average total passthrough amounts of \$95.21, or 7.9 percent of base rent.

There were eight units, or three percent of the total 266 in the sample, that had both a prior year passthrough and an accumulated passthrough. These units had an average base rent of \$1,442.41, an average current year passthrough amount of \$120.17, or 8.3 percent of base rent, an average prior year passthrough of \$52.36, or 3.6 percent of base rent, and an average accumulated passthrough of \$18.92. Tenants in this sample had average total passthrough amounts of \$191.44, or 13.3 percent of base rent.

Capital Improvement Passthrough Example

Exhibit 5 below shows an example of a unit with both a prior year passthrough and an accumulated passthrough. As shown, multiple capital improvement (and other) passthroughs approved by the Rent Board for the same tenant can result in rent increases in excess of the capped amounts allowed for individual capital improvement passthroughs (5 or 10 percent of base rent, depending on the number of units in a building). This is because the cap on capital improvement passthroughs only applies to a new passthrough for the first year after it is approved. If the tenant is already paying a previously approved capital improvement passthrough as part of their rent, the newly approved passthrough, up to the capped amount of 5 or 10 percent, would be added to existing passthrough amount. If the newly approved passthrough amount exceeds the capped amount, that excess amount would be “accumulated” and added to the tenant’s rent in the subsequent year, in addition to all previously approved passthrough amounts still being paid.

¹¹ In some cases, the accumulated passthrough is a minor correction to the amount the landlord had filed in the petition, which may be imposed at any time as long as the total does not exceed the five or ten percent annual limit.

Exhibit 5: Capital Improvement Passthrough Example

Current Petition Capital Improvements

	Improvement	Allowed Cost	Interest Rate	Allowed Cost with Interest	Years Amortized	Units Benefited	Monthly Per Unit Cost
1.	8 Windows	\$18,762	2.5%	\$22,526	15	1	\$125.14
2.	Chimney Flue Replacement	7,631	2.7%	9,890	20	1	41.21
Total Passthrough							\$166.35

Allowable Rent Increase due to Prior, Current, and Accumulated Passthroughs

Base Rent 4/26/18	Allowable Amount of Current Passthrough (5% of Base Rent)	Prior Capital Improvement Passthroughs	Total Monthly Rent 7/1/18	One-Time % increase on Base Rent	Accumulated Passthrough (May Be Imposed 7/1/19)*	Total Monthly Rent 7/1/19**	Total % increase on Base Rent
\$3,052.78	\$152.64	\$171.06	\$3,376.48	10.6%	\$13.71	\$3,390.19	11.1%

* This is the difference between \$166.35 approved and \$152.64 capped amount (5% of base rent)

**Does not include annual increase of 60% of CPI

In this example, a petition was filed and approved in 2018 for two capital improvements that benefited one unit in a three-unit building. As the allowed passthrough amount of \$166.35 exceeded the five percent limit of base rent, the landlord was able to pass through only \$152.64 of the \$166.35 cost per month to the tenant, starting on July 1, 2018. The tenant was already paying \$171.06 per month for two capital improvement passthroughs that were approved in 2012. Between the base rent and current and the prior passthroughs, the tenant would pay a total of \$3,376.48 per month, starting July 1, 2018, or 10.6 percent greater than base rent. Since the allowed passthrough amount of \$166.35 exceeded the five percent limit on base rent of \$152.64, the remaining amount of \$13.71 became an accumulated passthrough that could not be imposed until the subsequent year, or beginning on July 1, 2019. At that point, the tenant would pay a total of \$3,390.19 per month, or 11.1 percent greater than base rent (plus the regular allowable base rent increase of 60 percent of CPI).

In this example, the first passthrough to expire would be \$87.23 per month for exterior painting that was part of the prior passthrough of \$171.06 approved in 2012 and shown in Exhibit 5. This cost will amortize after 10 years, on October 1, 2022. The final passthrough to expire would be \$41.21 per month for the chimney flue replacement that would amortize after 20

years on July 1, 2038. The other previous and current passthroughs will expire in between these first and final expiration dates of all currently approved passthroughs. However, as there is no total cap on capital improvement passthroughs, additional petitions may be filed and approved at any time.

Multiple Passthroughs

The capital improvement passthrough petitions we reviewed did not state if the tenants had also been assessed other passthroughs, such as O&M rent increases, general obligation bond passthroughs, utility passthroughs, or water bond passthroughs. However, we know from our review of hardship applications, discussed further below, that tenants in some instances are being charged for passthroughs from multiple categories. Multiple passthroughs have no cap on the total allowed rate of rent increase. As general obligation bond and water bond passthroughs are formulaic, with allowable passthrough amounts specified on property tax and water bills, and utility passthroughs are typically small, we reviewed the properties where landlords had filed both capital improvement and O&M petitions.

We found 21 properties where the landlord had filed both a capital improvement and O&M petition over the two-year period of FY 2017-18 and FY 2018-19. These 21 properties are 2.5 percent of the 841 properties that had filed capital improvement petitions over the two-year period,¹² and 16.5 percent of the 127 properties that filed O&M petitions. We have not reviewed the decisions of these petitions and cannot determine the passthrough amounts.

Hardship Applications

As stated above, the City's Rent Ordinance allows tenants to avoid paying capital improvement passthroughs, O&M rent increases, utility passthroughs, and water bond passthroughs due to financial hardship. As mentioned above, a new ordinance approved in October 2019 created a hardship allowance for general obligation bonds approved by voters on or after November 5, 2019. To be granted a hardship allowance, tenants must file a hardship application with the Rent Board, providing documentation detailing their financial and rent circumstances.

¹² A total of 1,002 capital improvement petitions were filed over this period, but that includes properties that filed multiple petitions. A total of 841 unique properties filed at least one petition in this period.

As can be seen in the information presented below, tenants filing hardship applications were in units allowed rent increases by the Rent Board primarily through the passthrough process of between 1.9 and 8.4 percent, or in some cases well above the 2.2 and 1.6 percent rates of increase allowed by the Rent Board for those years without any passthroughs.

We reviewed 260 hardship applications that had been decided upon by the Rent Board between July 2017 and August 2019. Of these 260 applications, 243 (93.5 percent) were approved, eight (3.1 percent) were partially approved, and nine (3.5 percent) were denied. 165 applications were requesting relief from capital improvement passthroughs, 71 were for O&M rent increases, 15 were for utility passthroughs, and 104 were for water bond passthroughs.¹³ As passthroughs for general obligation bonds approved by voters before November 2019 had been ineligible for hardship waivers, there are none in our sample. As stated above, passthroughs for general obligation bonds approved by voters in or after November 2019 are now eligible for hardship waivers. A summary of passthrough amounts are shown in Exhibit 6 below.

Exhibit 6: Summary of Passthroughs in Hardship Application Sample

Group	Units	Average Base Rent	Average Total Rent Increase if Passthroughs Allowed	% Increase in Base Rent if Passthroughs Allowed
Full Sample	260	\$1,052.90	\$65.76	6.3%
Units w/ Capital Improvement Passthrough	162	\$1,084.55	\$79.37	7.3%
Units with O&M Increase	71	\$1,156.03	\$96.88	8.4%
Units w/ Utility Passthrough	15	\$593.11	\$11.35	1.9%
Units w/ Water Bond Passthrough	103	\$936.91	\$47.70	5.1%

In instances in which multiple passthroughs had been approved by the Rent Board, the tenant may file one hardship application to seek relief from payment of all passthroughs. Thus, the total of the various passthrough

¹³ This total exceeds 260 because many tenants had been assessed two or more types of passthroughs. In these cases, hardship applications were typically approved each of the passthroughs. That is, all passthroughs assessed to the tenant were waived and/or refunded.

categories shown above exceeds the 260 hardship applications filed, as many tenants had been assessed two or more types of passthroughs.

The average tenant applying for a financial hardship passthrough exemption had base rent of \$1,052.90 and was assessed average total passthroughs of \$65.76, or 6.2 percent of base rent. Total passthroughs ranged from \$1.85 to \$412.58.¹⁴ The 6.2 percent increase represents a significant increase in rent compared to the increase amount allowed by the Rent Ordinance for those two years: 2.2 percent from March 2017 through February 2018, and 1.6 percent from March 2018 through February 2019.

Of the 162 units with capital improvement passthroughs, the average base rent was \$1,084.55 and the average capital improvement passthrough amount was \$66.91, or 6.3 percent of base rent. The average total passthrough amount was \$79.37, or 7.3 percent of base rent.

Of the 71 units with O&M rent increases, the average base rent was \$1,156.03 and the average O&M passthrough amount was \$77.71, or 6.7 percent of base rent. The average total passthrough amount was \$96.88, or 8.4 percent of base rent.

Of the 15 units with utility passthroughs, the average base rent was \$593.11 and the average utility passthrough amount was \$7.49, or 1.3 percent of base rent. The average total passthrough amount was \$11.35, or 1.9 percent of base rent.

Of the 104 units with water bond passthroughs, the average base rent was \$936.91 and the average water bond passthrough amount was \$4.70, or 0.5 percent of base rent. The average total passthrough amount was \$47.70, or 5.1 percent of base rent.

Reasonable Reliance

The ordinance adopted by the Board of Supervisors in June 2018 prohibiting property tax and debt service from being included in O&M passthroughs allowed these increases to be considered in cases where the O&M petition was filed on or after December 11, 2017 and the property was purchased on or before April 3, 2018 if the landlord can demonstrate that he or she

¹⁴ In some cases, the assessed capital improvement passthrough exceeded the maximum allowable amount (five or 10 percent of petition base rent per year, depending on building type). In these cases, passthroughs may be assessed and gradually increased over two or more years, until the tenant is paying the full passthrough amount.

reasonably relied on the ability to pass through property tax and debt service costs at the time of purchase. This provision allows for increases typically greater than those attributable to other O&M expenses.

As of October 2019, the Rent Board has 30 pending O&M petitions under the reasonable reliance provision.

On October 21, 2019, Veritas Investments, one of the largest landlords in San Francisco with approximately 240 buildings and over 5,000 units¹⁵, announced that it will no longer pursue O&M passthroughs on petitions that it filed after December 11, 2017. Tenants will have any passthroughs they paid credited back to them before December 1, 2019. According to Veritas, this initiative will benefit 532 units across 34 buildings.

Banked Increases

San Francisco's rent control ordinance allows landlords to impose the allowable annual rent increase of 60 percent of CPI. If the landlord does not impose the full allowable increase each year, the landlord may impose skipped increases at a later date. These are known as banked increases. Banked increases have been allowable since April 1982.

There is no limit to the amount of increases that can be banked since April 1, 1982. There is also no time limit for imposing banked amounts. Landlords do not need submit petitions to impose banked increases, and the frequency of banked increases is not tracked by the Rent Board.

In our sample of 260 hardship applications, 36 tenants, or 13.8 percent, were subject to banked rent increases in addition to other passthroughs. The average banked increase alone was \$37.89, or 3.6 percent of base rent, which would be in addition to any allowed passthrough amount. It is unknown if the sample is representative of all rent controlled units in San Francisco.

Policy Options

1. The Board of Supervisors may consider instituting an overall, total cap on rental passthroughs. Unless AB 1482 is interpreted to cover passthroughs, there is no

¹⁵ Buildings owned by Veritas and other large landlords are typically registered under Limited Liability Companies (LLCs). When reviewing decisions issued by the Rent Board, it is often difficult to determine the true owner of the buildings.

total cap on passthrough-based increases. A total cap would assist tenants who have been assessed multiple types of passthroughs at the same time.

2. The Board of Supervisors may consider expanding the eligibility requirements for hardship qualification. To qualify for hardship based on income, a tenant must demonstrate that their monthly rent is greater than 33 percent of their gross income and that their gross income is less than 80 percent of area median income (AMI). The Board of Supervisors may consider modifying these parameters, such as allowing tenants to qualify for hardship if monthly rent is greater than 30 percent of the tenant's gross income or if the tenant's gross income is less than 90 percent of AMI.
3. The Board of Supervisors may consider placing limits on banked rent increases, such as creating a limit on the amount that could be imposed at one time or a time limit on imposing banked amounts.

Options 1 and 2 would help renters who have difficulty paying passthroughs but who do not currently qualify for hardship. However, they may deter landlords from improving their properties.

Option 3 would prevent tenants from receiving large rent increases at one time. However, tenants receiving banked rent increases would have foregone years of annual rent increases, saving money in the long run.