

CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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September 25, 2020

TO: Government Audit and Oversight Committee
FROM: Budget and Legislative Analyst 
SUBJECT: October 1, 2020 Government Audit and Oversight Committee Meeting

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<p>Item 1 File 20-0518 <i>Continued from 9/17/20</i></p>	<p>Department: Mayor’s Office of Housing and Community Development</p>
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EXECUTIVE SUMMARY

Legislative Objectives

- The proposed ordinance amends the Administrative Code to make Midtown Park Apartments subject to the Residential Rent Stabilization and Arbitration Ordinance.

Key Points

- In 2014, MOHCD entered into a lease with Mercy Midtown Inc. to manage the Midtown Park Apartments, and established the Rental Modification Program, setting rent rates for existing tenants, generally equal to 30 percent of household income. Because Midtown Park Apartments is a City-owned property, the apartments are not subject to the City’s Rent Stabilization and Arbitration Ordinance.
- According to the proposed ordinance initial base rent for tenants who have occupied their units since January 2014 (“legacy tenants”) would be set at the lower of (1) rent in effect as of May 2014, or (2) rent set by the Rent Modification Program.
- Initial base rent for tenants who began occupying their units after January 2014, rent would be the rent in effect at the time the tenancy commenced as determined by MOHCD’s then-current published maximum affordable rent schedule, or as determined by any successor affordable rent schedule or program for Midtown (“percentage rent”).
- Rent increases for (1) legacy tenants would be the allowable percentage increase to base rent in effect as of May 2014 set by the Rent Stabilization and Arbitration Ordinance, and (2) tenants paying percentage rent as base rent (including legacy tenants) would be the allowable rent under the current Maximum Rent Schedule published for each year, which could include a rent increase.

Fiscal Impact

- Total rents owed by legacy tenants would decrease by approximately \$500,000 if all legacy tenants elected to set base rent in accordance with the Rent Stabilization and Arbitration Ordinance. However, the actual decrease in rents owed by legacy tenants would vary depending on the number of legacy tenants who instead elected to set rent as percentage rent rather than rent subject to the Rent Stabilization and Arbitration Ordinance. The impact of the proposed ordinance on the City’s operating subsidy to Midtown Park Apartments would depend on operating expenses. The City’s operating subsidy Midtown Park Apartments varied from 850,000 in CY 2018 to \$425,973 in CY 2019.

Recommendations

- Request clarification from MOHCD and Rent Board on how the proposed ordinance would impact (1) tenants temporarily relocated from housing projects undergoing rehabilitation to Midtown Parks Apartments; and (2) would apply to back rent owed by 11 tenants.
- Approval of the proposed ordinance is a policy matter for the Board of Supervisors.

MANDATE STATEMENT

City Charter Section 2.105 states that all legislative acts shall be by ordinance.

BACKGROUND

Midtown Park Apartments are a City-owned housing project located at 1415 Scott Street in the Western Addition. The project, which opened in 1968 to provide housing to households displaced by urban development, consists of 139 housing units, which are a mix of three-, two-, and one-bedroom units. Fifty-three percent of the households are single person households, and the remaining households range from two to five persons. Sixty-five percent of the households are headed by an individual who is 60 years or older. Average household income is \$47,711, equal to 45 percent of the Area Median Income.

Income Restrictions

While the City subsidizes the operations of the Midtown Park Apartments, the project does not have deed or other restrictions mandating affordability. The original funding to develop the Midtown Park Apartments came from Department of Housing and Urban Development (HUD) loans, but affordability restrictions set by these loans are no longer in effect.

Property Management Lease

In 2014, the Mayor's Office of Housing and Community Development (MOHCD) entered into a lease and management agreement ("lease") with Mercy Midtown Inc. ("Mercy"), a nonprofit organization, to manage Midtown Park Apartments, including maintaining the property and improvements. The lease was month-to-month and therefore not subject to Board of Supervisors approval.¹

Under the terms of the lease, Mercy collected tenant rents, which were a source of income to be used in accordance with the annual budget approved by MOHCD. MOHCD is required to cover operating deficits, which is any revenue shortfall that is insufficient to pay for operations and maintenance of the property. The lease provided for Mercy to certify the income of all existing tenants and enter into rental agreements with the tenants. Mercy was then responsible to enforce the terms of the rental agreements.

At the beginning of the lease in 2014, Mercy was to maintain the existing rents for tenants, pending implementation of a Rental Credit Program by MOHCD. The second amendment to the lease, executed in March 2015, changed the name of the Rental Credit Program to the "Rent Modification Program". The second amendment provided for Mercy to enter into rental agreements with existing tenants by June 2015; rents were to remain unchanged from the 2014

¹ Administrative Code Section 23.31 states that leases of City-owned property that are year-to-year or less, including month-to-month leases, for which the fair market rent is \$15,000 or less per month, can be approved by the Director of Real Estate. Rent paid by Mercy to the City was \$1.00 per month.

rents until implementation of the Rent Modification Program, which required annual certification of tenant income. The Rent Modification Program contained the following provisions:

- Rents to be set at 30 percent of tenant’s income or market rate, whichever was less;
- Rent increases would be phased in over time for tenants paying less than 30 percent of their income;
- Rents would be reduced for tenants paying more than 30 percent of their income;
- Rents would be unchanged for tenants currently paying rent equal to 30 percent of their income.

The Rent Modification Program specified that no tenant would be evicted if their income was considered too high or too low.

Deferred Maintenance and Improvements

Between 2014 and 2019, Mercy completed repairs to the Midtown Apartments. The third amendment to the lease with Mercy provided for an allocation of Community Development and Block Grant (CDBG) funds of \$5 million to Mercy for emergency mold remediation of the property. In 2017, the fourth amendment increased CDBG funds to \$8.7 million for health and safety improvements to the property. The fifth amendment increased this funding to approximately \$9.5 million. According to Ms. Cindy Heavens, MOHCD Senior Project Manager, when the \$5 million repair began, there were 126 occupied units of the total 139 units. All of the occupied units were inspected, and based on the inspections repairs were completed on 123 units. All repairs with the CDBG funds were completed in 2019.

According to Ms. Heavens, the Midtown Park Apartments require additional repairs that need to be completed within the next 18 months, including repairs to the roofs, HVAC (heating, ventilation, air conditioning) system, fire safety, and other improvements and repairs. The estimated cost of the repairs needed to be completed in the next 18 months is approximately \$2 million.

Assignment of Lease

In January 2020, Mercy assigned the lease to Midtown Park Apartments – Kalco, LLC (“Kalco”), a limited liability company. Under the assignment agreement, MOHCD agreed to continue providing adequate funds to manage and operate the Midtown Park Apartments project to offset revenue shortfalls.

City Subsidy to Midtown Parks Apartments

Under the lease agreement between the City and Kalco, the City agreed to provide adequate funds to manage and operate the Midtown Park Apartments project, as noted above. According to the Midtown Park Apartments audited financial statements, the City’s subsidy to the Midtown Park Apartments in CY 2018 was \$850,000 and in CY 2019 was \$425,973.

DETAILS OF PROPOSED LEGISLATION

Note: This report is based on amendments submitted in the Government Audit and Oversight Committee on September 17, 2020.

File 20-0518 is an ordinance amending the Administrative Code to subject dwelling units at Midtown Park Apartments, a residential development owned by the City and County of San Francisco, to the Residential Rent Stabilization and Arbitration Ordinance; and making findings pursuant to as required by the California Tenant Protection Act of 2019. According to the proposed ordinance:

Initial base rent for:

- Tenants who have occupied their units since January 2014 (“legacy tenants”) would be set at the lower of (1) rent in effect as of May 2014, or (2) rent set by the Rent Modification Program.
- Tenants who began occupying their units after January 2014, rent would be the rent in effect at the time the tenancy commenced as determined by MOHCD’s then-current published maximum affordable rent schedule, or as determined by any successor affordable rent schedule or program for Midtown (“percentage rent”).

Rent increases for:

- Legacy tenants would be the allowable percentage increase to base rent in effect as of May 2014 set by the Rent Stabilization and Arbitration Ordinance.
- Tenants paying percentage rent as base rent (including legacy tenants) would be the allowable rent under the current Maximum Rent Schedule published for each year, which could include a rent increase.

Tenants who paid more than the allowable rent increase between May 2014 and the effective date of the proposed ordinance would receive a rent credit against future rents.

Legacy tenants who opt to set base rent at the 2014 amount, with rent increases subject to the Rent Stabilization and Arbitration Ordinance, will have a one-time option to elect to switch to percentage rent.

Vacant Units

Twenty-two of the 139 housing units at Midtown Park Apartments are vacant. According to MOHCD staff, 17 of the 22 vacant units will be made available under a master lease to tenants temporarily relocated from other affordable housing projects that are undergoing rehabilitation. The Board of Supervisors should request clarification from MOHCD and the Rent Board on how these future tenants will be impacted under the proposed ordinance.

FISCAL IMPACT

When the Rent Modification Program at Midtown Parks Apartments was implemented in June 2015, which increased rents to 30 percent of household income:

- 86 tenants had existing rents less than 30 percent of household income and therefore had rent increases phased in over five years, with the median increase equal to 75 percent; and
- 21 tenants had existing rents greater than 30 percent of household income and therefore had rent decreases, with the median decrease equal to 30 percent.

According to rent roll data for Midtown Park Apartments, provided by MOHCD, total rents owed by legacy tenants would decrease by approximately \$500,000 if all legacy tenants elected to set base rent and subsequent annual increases in accordance with the Rent Stabilization and Arbitration Ordinance. However, the actual decrease in rents owed by legacy tenants would vary depending on the number of legacy tenants who instead elected to set rent as percentage rent rather than rent subject to the Rent Stabilization and Arbitration Ordinance.

The impact of the proposed ordinance on the City's operating subsidy to Midtown Park Apartments would depend on operating expenses. As noted above, the City provides an annual operating subsidy to Midtown Park Apartments, which varied from 850,000 in CY 2018 to \$425,973 in CY 2019.

POLICY CONSIDERATION

As noted above, the Board of Supervisors should request clarification from MOHCD and the Rent Board on how tenants temporarily relocated from housing projects undergoing rehabilitation to Midtown Parks Apartments would be impacted by the proposed ordinance.

Also, according to the rent roll data provided by MOHCD, eleven tenants who had rent increases in 2015 now owe back rent exceeding \$20,000. The Board of Supervisors should request clarification from MOHCD and the Rent Board on how the proposed ordinance would apply to back rent owed by the 11 tenants.

RECOMMENDATIONS

1. Request clarification from MOHCD and the Rent Board on how the proposed ordinance would impact (1) tenants temporarily relocated from housing projects undergoing rehabilitation to Midtown Parks Apartments; and (2) would apply to back rent owed by 11 tenants.
2. Approval of the proposed ordinance is a policy matter for the Board of Supervisors.