GOVERNMENT OF THE DISTRICT OF COLUMBIA
Department of Housing and Community Development

B23-0873 – "Rent Stabilization Program Reform and Expansion Amendment Act of 2020"

B23-0972 – "Hardship Petition Reform Amendment Act of 2020"

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

Virtual Hearing via Zoom

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Good afternoon, Chairperson Bonds and members of the Committee on Housing and Neighborhood Revitalization. I am Polly Donaldson, Director of the Department of Housing and Community Development (DHCD). I am pleased to appear before you to testify on behalf of Mayor Bowser on B23-0873, the "Rent Stabilization Program Reform and Expansion Amendment Act of 2020" and B23-0972, the "Hardship Petition Reform Amendment Act of 2020".

As part its mission to produce and preserve affordable housing for low- and moderate-income residents and revitalize underserved neighborhoods in the District of Columbia, DHCD houses the Rent Administrator who administers the Rental Housing Act and its provisions popularly known as rent control[1].

On September 24, 2020, I came before you to testify on another set of bills related to rent control.[2]. In many ways, the hearing held today, continued from last week, completes that discussion. Bill 23-0972, the "Hardship Petition Reform Amendment Act of 2020" addresses the remaining housing provider petition in the Rental Housing Act not addressed in the September 24 hearing, and Bill 23-0873, "Rent Stabilization Program Reform and Expansion Amendment Act of 2020", for

[1] The Rental Housing Act of 1985 (DC Law 6-10, DC Official Code § 42-3501.01 et seq). The rent control provisions can be found in subchapter II of the Act, "Rent Stabilization Program" and its supporting regulations (DCMR Title 14, Chapters 38-43).
[2] Bill 23-0237, the "Rent Concession Amendment Act of 2019"; Bill 23-0530, the "Rent Stabilization Affordability Qualification Amendment Act of 2020"; Bill 23-0877, the "Substantial Rehabilitation Petition Reform Amendment Act of 2020"; Bill 23-0879, the "Capital Improvement Petition Reform Amendment Act of 2020"; and Bill 23-0878, the "Voluntary Agreement Moratorium Agreement Act of 2020".

its part, addresses many of the same concerns of the preceding bills and also proposes to expand the number of rental housing units that are covered by rent control.

Before I start the body of my testimony, I want to emphasize our support for this comprehensive effort to update and improve the District's rent control regime. While we recently supported the extension of the important protections of the current rent control statute for another decade, we also recognize that the statute is long overdue to be updated and reformed for it to continue to effectively meet its statutory purposes, which I paraphrase here:

:

(1) To protect low- and moderate-income tenants from increased housing costs;

(2) To provide incentives for the construction of new rental units and the rehabilitation of vacant rental units;

(3) To improve the resolution of disputes and controversies between housing providers and tenants;

(4) To protect the existing supply of rental housing from conversion to other uses; 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. (DC Official Code § 42–3501.02)

Thank you for persisting in this important work.

A Reasonable Rate of Return

I will start by noting that the "Hardship Petition" in the current rent control statute recognizes that housing providers have the right to earn a reasonable return from their property. If housing providers are not able to earn a profit, not only could rent control be construed as a government taking, but over time this will have detrimental impacts on the tenants themselves as even basic investment in the housing accommodation inventory suffers.

The hardship petition complements the Capital Improvement and Substantial Rehabilitation petitions, which enable a housing provider to cover costs for major repair investments to a property, and the Voluntary Agreement Petition that allows tenants and housing providers to privately negotiate rents and property improvements according to the statute. Proposed reforms to these other petitions were discussed at the hearing on September 24, 2020.

When it comes to Hardship Petitions, the current statute allows housing providers to petition the Rent Administrator for increases in rent "which would generate no more than a 12 percent rate of return." If the owner submits a petition with supporting documents to the Rent Administrator, which prove that for 12 of the last 15 months the rate of return falls below 12 percent, and this is due primarily to the restrictions on rents, they can file a Hardship Petition. The Rent Administrator will then notify the tenants that the petition has been filed, allowing the tenants to designate a representative to support or oppose it. The Rent Administrator will engage an auditor to perform an audit of the hardship petition and supporting documents. Based on the findings of the audit, the Rent Administrator issues an order granting or denying the hardship petition. If the housing provider or tenants contest the Rent Administrator's order, a hearing will be held with the Office of Administrative Hearings (OAH) to resolve the disputed matters. After its consideration of the dispute is complete, OAH then issues an order either denying or setting the rent increase.

The Hardship Petition comes under significant criticism because it allows permanent rent increases above what would typically be allowed under rent control's "annual increase of general applicability" and without requiring any major improvements or repairs to the property. It is seen by many as "guaranteeing" housing providers a 12 percent return.

Both the “Hardship Petition Reform Amendment Act of 2020” and the “Rent Stabilization Program Reform and Expansion Amendment Act of 2020” propose to reduce the rate of return that triggers a Hardship Petition in similar ways.

The “Rent Stabilization Program Reform and Expansion Amendment Act of 2020” would set rate of return, what is to be newly termed the “guaranteed profit margin”, to the average daily yield curve rate on a 10-year United States Treasury note for the month of January of each current year, as published by the United States Treasury Department. This bill would only allow such increases to be implemented in annual increases of up to 5 percent.

For its part, the “Hardship Petition Reform Amendment Act of 2020” uses the exact same basic definition but adds 2 percent to the Treasury rate and caps the total increase for any petition at 8 percent.

The original 12 percent threshold may have seemed reasonable in an era kicked off by the oil embargo in the 1970s, which was marked by wildly fluctuating month-to-month inflation rates. During this period from the middle of the 1970s through the early 1980s, the inflation rate vacillated from nearly 15 percent to below 5 percent. But today, with inflation hovering consistently around 2 percent and treasury rates and other basic investment types earning similarly low returns, 12 percent seems an outsized return, as many District Residents testified last Monday before this hearing recessed.

However, if the country were to ever experience such a volatile economic period as it experienced following the first oil embargo, the standards proposed in these bills could not guarantee a rate of return above inflation and a successful hardship petition would likely offer little if any relief as both wages and other operating costs soared with inflation. Even without such an increase in inflation, the Treasury rate can be below the rate of inflation.

The difficulty the two approaches share is that neither the current fixed 12 percent threshold nor the Treasury-rate-based approaches proposed in today's legislation has a direct relationship to costs or returns of operating rental housing in the District of Columbia. While the reference is often made to the impact this legislation will have reducing the returns of operating rental housing in the District of Columbia relative to other jurisdictions or to selling the units as condominiums or cooperatives, perhaps another comparison is more straight forward. If investors are offered the choice between operating rent-controlled housing in the District knowing that no matter the market's strength, they may be limited to returns at or near the Treasury rate set each January, on the one hand, and simply holding the government paper itself on the other, most reasonable investors would choose the Treasury notes. What is the incentive for owning and operating rental housing?

The distinct risk profiles of these two types of investments could be no clearer than in the moment we find ourselves today. Throughout, the period prior

to the COVID-19 public health crisis, a rental property may have had returns above the Treasury rate. During the crisis, however, disrupted tenant incomes, an eviction moratorium, increasing operating costs, rising vacancies, and an uncertain future have meant negative returns for many housing providers, particularly small housing providers property owners who own fewer units to spread these costs over. Without the higher returns during a strong economy, average returns over the entire period quickly turn negative. Ten-year Treasury notes bought during the first period would not have this risk, providing the same guaranteed return throughout the entire period.

I recognize that the COVID-19 economy is an extreme example. I also recognize that historically, operating rental housing in the District has been a safe and low-risk investment. But the current rental market upheaval also makes the necessary point: simply replacing one arbitrary standard with another is not an improvement to the policy.

If the current standard is to be changed, we recommend it be based on an analysis of the historical relationship between readily available and understood measures of investment returns in the broader economy and the costs of operating rental housing in the District. This may be as simple as pegging the "guaranteed profit margin" to some percentage above consumer inflation, but there is likely a better index that can be found or developed that more directly related to the goods

and services housing providers purchase and the risks they face, that will vary as the economy changes.

We also recognize that the annual 5 percent limitation on increases contained in both these bills has value in limiting annual increases as a protection against single year price shocks, particularly important in an environment as unsettled as the mid-1970s and what we may yet see as a result of the pandemic today. Still, the proposed percentage seems arbitrary and this should also be the subject of the analysis and recommendations.

It is also possible that the statute could direct the Rental Housing Commission to study and update the chosen measure on a regular basis with public comment based on the latest data and understanding of the relationship between costs and relative investment risk.

This concern is not limited to the Hardship Petition.

Limiting Regular Rent Increases to the Rate of Inflation

The "Rent Stabilization Program Reform and Expansion Amendment Act of 2020" would go a step further by limiting the "automatic" adjustment of general applicability rent increases to the flat change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). We are not able to support this proposal for similar reasons as those discussed above and again suggest if the

current standard is to be changed it be done after further study to determine an appropriate and robust limitation to annual rent increases.

But it must also be said that limiting rent increases to consumer inflation almost by definition means a housing provider cannot improve their own standard of living by owning rental property in the District since they can only expect to keep pace with inflation at best. Not only would this proposal itself severely limit the opportunity for housing providers to earn a reasonable return, but in combination with the proposed severe limitations on Hardship Petition related rent adjustments and voluntary agreements, the opportunities in owning and operating decent and legal rent controlled housing in the District of Columbia without government subsidy would all but disappear.

Elimination of the Vacancy Adjustment

Another significant reform on the table today is the elimination of any rent adjustment based on a rental unit vacancy, which is contained in the "Rent Stabilization Program Reform and Expansion Amendment Act of 2020". As you are aware, as of March 2019 the vacancy adjustment has been 10 percent, reduced from the 30 percent that existed previously, as a result of the "Vacancy Increase Reform Amendment Act of 2018".

We continue to not be in favor of making a further reduction to this adjustment. As we testified in reference to the precursor legislation B22-0025, the "Rental Housing Affordability Stabilization Amendment Act of 2017", there can be significant turnover costs associated with vacancy and often costs associated with deferred maintenance and improvements to the units that are difficult to address in an occupied unit. We need to better understand the impact of the most recent reduction in vacancy adjustments on the quality and stock of rental housing before making any further changes.

Temporary Rent Surcharges.

Another area that needs further consideration is the amendment of references to rent adjustments to rent surcharges. The bills before you today and those discussed at the September 24 hearing, all favor a greater reliance on temporary rent surcharges rather permanent rent adjustments. Relying on a temporary rent surcharge is often warranted, as the expense of an improvement is eventually paid off, and the value of most improvements and rehabilitation efforts depreciates and eventually disappears.

In the case of the Hardship Petition, however, this turn to rent surcharges raises significant questions. The problem being addressed, the mismatch between the fundamental operating costs and rent collections at the property, has no IRS

schedule, payback period or useful life to reference. It is unclear why we might expect there to be *deflationary* pressures in the economy or the operation of the property, that would push the nominal costs at the property lower, particularly just three years after an increase was first granted. In the absence of a clear logical argument or analysis of the need for this change, we believe the requirement for a re-examination every three years of every rent increase granted under a Hardship Petition will just add administrative complexity and costs in return for little policy value.

But this does raise another important consideration. Separate and apart from the policy decision about where to apply temporary surcharges, we recommend an annual rent surcharge reporting requirement be established for all such surcharges to allow all the parties more easily monitor and track which have been approved and which are pending, implemented, unimplemented, and expired. This could be streamlined through the rent control database currently under development at the Office of the Tenant Advocate.

Timing of Inspections and Code Compliance

Throughout these rent control reform bills, housing providers are required to have properties inspected and up to code prior to filing a petition. We recommend that the language be revised so that the housing provider must abate all substantial

violations by the time the petition is approved rather than "prior" to the filing of the petition. This is because housing providers may not have the resources to correct housing code violations prior to filing a petition and correcting the violations may be the underlying reason that a housing provider files a hardship petition. Without this change, a chicken and egg problem likely presents itself.

Additional Proposed Reforms

Many of the remaining proposals in the bills under consideration today are also very similar to the changes proposed the "Substantial Rehabilitation Petition Reform Amendment Act of 2020 and the "Capital Improvement Petition Reform Amendment Act of 2020"

As I noted on September 24, while these reforms address significant areas of concern to tenants and housing providers alike, DHCD has concerns about the administrability of some of these reforms and the use of ambiguous language. The Rent Administrator has also identified a number of missed opportunities to clarify longstanding interpretative issues with the Rental Housing Act. One example that comes to mind is the small landlord exemption provision. The Rental Accommodations Division (RAD) frequently encounters problems with housing providers who seek the small landlord exemption. Caselaw has mostly developed

the small landlord definition, which is not evident to someone applying for the exemption.

We are also concerned that some of the proposed changes could be better addressed by the regulatory updating and improvement effort currently being carried out by the Rental Housing Commission.

We are grateful that your committee staff followed up with us after that hearing and we have already begun to work through these matters together. I would like to recommend that our teams continue to meet and iron out the details of these important reforms.

Expanding Rent Control

Up to now my testimony has focused on the elements of these bills that propose to refine and improve the District's current rent control regime. The "Rent Stabilization Program Reform and Expansion Amendment Act of 2020", however, also covers new territory by also proposing two ways to extend rent control to new properties: specifically, those properties built after 1975 and up to 15 years before the current date and those owned by an owner that owns four units would no longer be exempt from rent control.

As I have testified previously, when the subject was the extension of the current provisions for another decade, the Bowser Administration feels that the

current Rent Control regime provides valuable protections to the tenants and that a well-designed rent stabilization regime also can support a stable rental market, encouraging investment by responsible housing providers and discouraging those who do not want to be partners with the District and its residents in supporting secure households and vibrant neighborhoods.

But I must note that the majority of the provisions in the two bills before you today and the September 24th hearing, raise and seek to address serious concerns with the current system. The public testimony suggests these concerns must be urgently addressed. We therefore believe the first step must be reform of the current system before there can be any discussion of expansion to new properties.

I will use this opportunity, however, to note a significant concern with the expansion proposed here. There is no consideration in this bill of the fact that for properties with ten or more units, built after 2007, the District regulates rents and maintains affordability through the Inclusionary Zoning (IZ) program. In these otherwise market-rate rental properties, eight percent or more of the units are rent *and* income restricted for households earning below 60% - and sometimes below 50% - of the area median family income. Any rent control expansion proposal such as the one in Bill 23-873 must expressly and fairly address the treatment of Inclusionary Zoning properties and respect the agreements these properties must provide affordable housing for the life of the building.

Addressing the Need for Affordable Housing

This is a fitting transition to the last portion of my testimony. I have spent the bulk of my testimony discussing the technical aspects of the bills before you but I think we all realize that rather than being focused on these technical matters, most of the testimony in the first portion of this hearing focused on the need for affordable housing in the District of Columbia, plain and simple. And many of those who testified recognized that when it comes to making housing more affordable for lower income households, rent control is not the only or even the best tool in our toolbox.

This is why Mayor Bowser has focused our efforts on a number of initiatives, stated clearly in the report of the Housing Preservation Strikeforce, her Mayor's order of May 2019 and in the Housing Framework for Equity and Growth report published a year ago.

Along with continuing robust funding for programs such as the Housing Production Trust Fund and the DC Housing Preservation Fund, which have created thousands of rent and income assisted affordable units, there are other initiatives we are undertaking to achieve these goals. Passing the new Comprehensive Plan, on which you just recently have received public comment, would make room for affordable housing across our city and make affordable housing a priority in our

development efforts. Passing the Comprehensive Plan is one of the fundamental ways in which we can support affordable housing in the District.

Another new initiative, Expanded IZ, would require increasing numbers of rent and income restricted inclusionary zoning units in new projects when developers request zoning map amendments, and is currently before the Zoning Commission.

We will continue to utilize every tool at our disposal and develop new tools to make housing more affordable across the entire city.

Conclusion

In conclusion, I will say the number and length of the bills and the concerns I and others continue to raise highlight the complexity of the task you have undertaken. The public's engagement in this issue at this and other recent hearings is an indication of how important it is that we get it right. I again commit to you, Chairwoman Bonds and members of the committee, to be a good partner in bringing rent control into the 21st century and developing the next generation of tenant and rental market protections.

Thank you, for the opportunity to testify today. I would now be happy to answer any questions you may have.