



News for Mobilehome Park Owners

June 2009

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Federal Court Orders Immediate Vacancy De-Control

A Federal District Court has ordered immediate vacancy rent decontrol in San Rafael, California and further ordered that the City's Rent Control Ordinance will terminate completely in ten years, in *MHC Financing, Ltd. v. City of San Rafael*. This decision implements the Court's earlier decision which found that San Rafael's mobilehome park rent control law reduces the value of the park by \$97 Million.

The Court had examined the effect of the City's rent control Ordinance and whether it met its stated objective of providing affordable housing. The Ordinance limited rent increases to 75% of CPI and prohibited greater rent increases even for new lessees (vacancy control).

The Court found that the combination of depressed future rents and vacancy

control caused prospective buyers of park homes to pay a much higher price to purchase the home from the existing tenant than the intrinsic value of the home itself. "In this manner," the Court wrote, "the reduction in rents was 'capitalized' into the value of the mobilehome. Thus, [the Ordinance] created an inevitable premium in the resale value of mobilehomes...."

Every park owner living under rent control has seen a home with a NADA value of \$7,000 sell for \$100,000 - \$200,000 because the rent is restricted to a fraction of market rental rates. In this way, value is taken from the park owner and given to the former resident. The Court found that because the rent control

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A Perfect Buyer's Market?

Now is an ideal time to purchase a mobilehome park. Everyone realizes that financing is difficult to obtain. Potential buyers are being conservative and trying to remain liquid. Vacancies are increasing in mobilehome parks. Park owners are accruing rents or reducing rents to retain tenants.

This is truly a perfect time!!

Although many owners decided this is the wrong time to sell, some park owners have no choice. Owners have loans with quickly approaching due dates. They realize that it will be difficult to refinance because of reduced values, illiquidity in the financial markets, reduced rents, etc. They have to sell.

A park owner passes away and the estate needs liquidity for taxes or the heirs do not want to have the management responsibility or the risk of decreasing value of the property.

Many park owners will trade the risk of ownership with the cash flow from seller financing. There are tax opportunities for installment sales by park owners.

We have seen buyers purchase parks with the seller financing a major portion of the sale price. The banks and money market funds are paying one or two percent, a buyer willing to pay the seller six percent is creating a great opportunity for a motivated seller.

If you have confidence in the manufacturing housing community business, then 2009 may be the best opportunity to purchase parks. Creative financing by buyers allows sellers to obtain their goals and buyers to structure purchases with the maximum leverage.

My Park Has No Rent Control, Why Would I Want To Subdivide?

A popular misconception is that subdivision of a mobilehome park (otherwise known as conversion to resident ownership) is sought by park owners merely as a way to escape rent control. NOT TRUE!!

While it is true that upon conversion, local rent control is replaced with State rent provisions, we are assisting owners with parks in non-rent control jurisdictions seeking conversion as well. What, you may ask, is the advantage of subdividing if your park's rental return rate is reasonable?

Having an approved subdivision map offers park owners an option for the future.

Without rent control, you may be earning a fair return on your investment – or better.

However, looking down the road, there is going to come a day when you or your heirs may no longer want to be in the mobilehome park business. When that time comes, whether it is next year or ten years from now, your park will be significantly more valuable sold lot by lot rather than wholesale. Even if you were to ultimately decide to sell it as a whole, your park will command a much higher price when it comes with a “vested” subdivision map.

You might think your park is the greatest investment you ever made, and that it is the best thing you can leave your children. But, things change – think of the railroad barons who thought leaving a railroad to the next generation was providing them a windfall for their future. Well, we all know the fate of the railroads; times change (so do laws).

Clarke Fairbrother, park owner and Managing Partner of Newport Pacific Management Co., has obtained subdivision map approval for a park in a non-rent control jurisdiction and is currently seeking

another. As Clarke says, “It is hard to predict the future from the grave. You have more options with map approval.”

Converting your park to resident ownership provides the best value for you and your residents as well. While providing you, the park owner, retail value for your real estate, it also provides an opportunity for your tenants to own the park, which they think of as their home.

Imagine if you owned a stick-built rental house which your tenant had been renting from you for the past 15 years. When it came time to sell, who would you go to first as a potential buyer? The current residents will be your most likely buyers, especially in a mobilehome community where they already have a significant investment. For those of you who have a caring and long standing relationship with your residents, offering them ownership is certainly a more benevolent exit strategy that selling to the highest wholesale bidder.

The value of a park is appreciably diminished by spaces filled with circa 1960's homes. One of the benefits of conversion to resident ownership is that lot by lot, as the park is sold over time, newer model homes are brought in due to better financing options for the residents and a more upscale community will appeal a different quality of buyer. Additionally, retail lot sales will provide you the capital needed to upgrade your community, which will also increase its value and desirability.

So, whether you are planning your long-term future or retirement is around the corner, subdivision is the best strategy for many mobilehome community owners who want to maximize value.

“It is hard to predict the future from the grave.”

Ask the Experts!

Welcome to our first “Ask the Experts” column! This is your forum to submit your specific questions or industry-related issues to our mobilehome team to get the answers YOU need.

Paul from the Bay Area asks:

I have read in your Newsletters that park owners are entitled to a reasonable return on their investment. I have two questions: (1) How do I begin this process; and (2) How do I know that the legal costs incurred will not outweigh the possible benefits?

Answer:

Some rent control laws – but not all – contain a provision allowing for a reasonable rate of return calculation. Even if your city/county ordinance is silent on this point, the courts have stated that you are entitled to a profit sufficient to provide you with a reasonable rate of return.

Your profit should be between 9 and 12 percent per annum on your equity.

The first step is for us to determine what amount of rent increase you are entitled to. The amount of annual rent increase will raise the value of your park by approximately 12 times the amount of the increase. For example, a \$50,000 annual rent increase will escalate the value of your park by \$600,000.

Increased profit and park value have generally been proven to considerably outweigh the legal costs of obtaining such financial benefits.

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If you have industry-related questions that you would like to see covered in future Newsletters, please e-mail us at:

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reporter

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Community owner to invalidate rent control

Longtime WMA member and industry trailblazer James F. Goldstein has challenged the city of Carson's rent control ordinance, which could change rent control rules for community owners throughout California.

For many years, Goldstein has been an aggressive player in the manufactured housing industry as he forged the way through the court system and ultimately made the law on conversion/subdivision of communities through his case of *El Dorado Palm Springs, Ltd., v. City of Palm Springs*, 96 Cal. App. 4th 1153 (2002). In fact, the city of Palm Springs recently settled the damages portion of that case with Goldstein for nearly \$1 million.

Building on that success, Goldstein, along with his legal team, recently filed the most important U.S. Federal Court rent control case since the U.S. Supreme Court decided *Yee v. City of Escondido*, 503 U.S. 519 (1992), which created the current law.

If successful, this case could not only lead to the manufactured home rent control law in the city of Carson being deemed unconstitutional, but could pave the way for a federal system of minimum rent rules. This would benefit all California community owners because, as we all know, the state rules give tremendous deference to local rent control boards.

You may not know it, but you are entitled to a fair return on your investment in your community. This is true even if your city does not have a specific provision for a fair return in its ordinance. Yet seldom if ever do cities with rent control allow rents that will provide community owners with a fair return. When community owners do apply, many cities will try to delay, manipulate, or deny the petition.



Authors (l-r) Thomas W. Casparian, Esq., Richard H. Close, Esq. and Susy Forbath

That is exactly what happened to Goldstein. Even though it is a violation of the U.S. Constitution to prohibit community owners from receiving a reasonable rate of return on their investment, the city of Carson is apparently politically committed to keeping rents unconstitutionally low.

R.S. Radford, a principal attorney at the Pacific Legal Foundation, agrees: "Sooner or later, California cities will have to learn that they can't meet their affordable housing goals by forcing a few property owners to foot the bill. That's what rent control laws like this one are all about, and that's why Carson's rent ordinance is unconstitutional."

Currently, the residents in Goldstein's community, Colony Cove Mobile Estates, pay an average of \$400 per month space rent, while market rents would be more than \$800 per month. This gap deprives the owner of more than \$30 million of property value, and causes the community to operate at a substantial loss each year.

Worse yet, this value is directly transferred to the Colony Cove residents, who on average have been receiving upon sale more than \$118,000 for their manufactured homes that have an average NADA value of \$33,000. Taking property from party A to give to party B, however, is unlawful and unconstitutional. See *Kelo v. City of New London*, 545 U.S. 469, 477 (2005).

Goldstein's case challenges the city of Carson's restrictive and confiscatory rent control scheme, which deprives the community owner of the right to obtain reasonable rents. In addition to having the city's rent control system declared unconstitutional, the suit seeks \$34 million in damages, along with a minimum rental increase of \$200 per month for each space in his community.

As a community owner, how might this action affect you?

Although you are entitled to a fair return on your investment, a fair return is elusive and community owners are not permitted to charge rents that come anywhere close to market rents.

In addition, Carson, instead of using pre-rent control net operating income to anchor their calculation, uses the community's net operating income from the last year that it granted a rent increase as a base period. This flawed methodology is further exacerbated by the fact that the city may adjust the net operating income in an arbitrarily-selected base year by less than 100 percent of the inflation rate.

Many rent control schemes explicitly depend on this nonsense calculation, which is clearly based more on *ad hoc* political considerations than on ensuring a fair rate of return.

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Community owner to invalidate rent control

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If your community is located in a city that irrationally, arbitrarily, or capriciously sides with the community residents and has denied you a fair and reasonable rate of return, you too may be able to challenge the city and get the fair return to which you are entitled.

It is important to recognize, however, that you only have a short timeframe in which to challenge the city's conduct, due to statutes of limitations. But you, just like James Goldstein, have the right to a fair return on your investment and to transfer the value of land back to you, its rightful owner.

Some community owners, like Goldstein, are utilizing this right to a fair market return in conjunction

with subdividing their community. Once residents realize that the owner is entitled to a fair return and they are faced with higher rents, the idea of purchasing their

"...you too may be able to challenge the city and get the fair return to which you are entitled."

lots at fair market value (resident ownership) becomes more attractive. Simultaneously converting the community to resident ownership creates a win/win for community owners by providing fair market rents and/or a fair market value for the subdivided land.

For Goldstein, it has been determined that the city of Carson's rent control scheme has transferred over \$34 million of the community's value to its residents, which he is seeking to have returned. How much property value have you lost?

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Gilchrist & Rutter represents James F. Goldstein in his challenge of the City of Carson's rent control ordinance.

Federal Court Orders Immediate

Vacancy De-Control

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Ordinance did not change the total amount that prospective residents would pay to live at the park (home price plus rent), the Ordinance did not contribute to the availability of affordable housing in the City. Because the Ordinance did not advance its stated purpose and reduced the value of the park significantly, the Court found that it effected an unconstitutional "taking" of the Park owner's property and invalidated it.

In its recent order, the Court rejected the City's request to stay the decision during any appeal (which is uncertain at this stage given the City's finances). The Court balanced the hardship to the Park's current residents if their rents were to increase substantially against those of the Park owner who has been and will be greatly harmed while operating under the burden of an unconstitutional law. It ordered that the rent control Ordinance would not apply to any future residents, and that the Ordinance would expire as to all resident in ten years.

The Court also ordered that the City pay the Park owner's legal fees of \$1.8 Million. The park owner should additionally be entitled to millions of dollars in damages from the City.

The Court's decision is already being cited by other parks in their rent control lawsuits, including *Colony Cove Properties, LLC v. City of Carson*, another federal action by this firm seeking to invalidate a rent control ordinance. The Federal Court has found what every park owner knows: mobilehome park rent control wrongfully takes value from their property and gives it to current residents without contributing to affordable housing. Park owners now have the ability to use this decision to show other courts that their property is being taken wrongfully as well.

Representing mobilehome park owners
for over 25 years,

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