



News for Mobilehome Park Owners

March 2009

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The Five Most Common Rent Control Mistakes

Over 100 cities and counties in California impose rent control on mobilehome parks. The vast majority of these jurisdictions do not have any vacancy decontrol. The rent regulations were mostly imposed in the late 1970's and the result today is rents for most regulated spaces are far below what they were then, as adjusted for inflation, although other rental housing has seen huge increases.

Efforts at challenging rent regulations and their application to specific situations are ongoing, sometimes with significant success. However, many park owners do not take full advantage of opportunities under current laws to increase rents. The following are common "mistakes", lost opportunities actually, that we see park owners and management make too often.

- **Don't underestimate the value of a "small" rent increase.** A mere additional \$5 per space monthly rent increase translates into \$240,000 increased value for a 200-space park (using a 5% cap rate). At refinancing, this additional equity would permit the park loan to be increased by approximately 70% of that amount, resulting in \$168,000 to the owner, *tax free*.

- **Know your local rent control ordinance, and its implementation regulations, like you know your own name.** Some ordinances are extremely detailed and contain critical substantive and procedural opportunities, and many fatal pitfalls. Other ordinances contain only vague and generalized principals, but the implementation regulations, or "guidelines", have the necessary detail.

As one example, many local guidelines allow capital improvements up to a certain annual amount to be treated as operating expenses. In a jurisdiction that requires a showing of increased operating expenses or decreased net operating income (NOI) to justify a rent increase, the ability to treat an expense as operating income, which results in a permanent rent increase, rather than a capital improvement which results only in a temporary pass-through, can make a big difference in income and park value.

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Questions? Contact our team of MHP experts by e-mail at MHPG@gilchristutter.com

Sacramento Legislative Update – Senate Bill 23

Senator Alex Padilla has introduced Senate Bill 23, imposing a state-mandated local program which would require, on or after January 1, 2010, park operators to develop and implement an emergency and fire safety plan and emergency services training for park managers and onsite staff.

On February 6th the Senate Select Committee on Manufactured Homes and Communities held their second Hearing to discuss wildfire related issues affecting mobilehome communities and manufactured homes. The purpose of the Hearing was to review fire safety issues in parks such as upgrading exterior construction of homes, increased brush control, park emergency preparedness and evacuation planning, and jurisdiction overlap (State vs. Local enforcement).

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“No Pain, No Gain”

On January 27th the City of East Palo Alto approved the conversion/subdivision of the 117-space mobilehome community Palo Mobile Estates.

The subdivision of Palo Mobile Estates began with what most park owners would think of as pain. Resistance from the residents led to opposition from the City, which led to litigation and associated costs. But once we had leverage of having won the legal battle, the rest of the process became cooperative and painless. And what initially felt like only pain to the park owner, now feels like nothing but gain.

What made the East Palo Alto project interesting was the use of a mediator. The city requested that there be a one-day mediation with a retired judge. The goal was to determine if the concerns of the residents could be dealt with by the owner.

The residents selected the mediator from a list supplied by a Dispute Resolution firm, and residents felt comfortable with this retired judge.

Two City Council members and the City Attorney agreed to participate in the mediation. They saw firsthand the unreasonable demands of the residents and that many of their concerns were based on speculation. They also saw that the park owner was willing to solve legitimate problems presented by the residents.

The mediator, selected by the residents as impartial, was able to explain restrictions that the State law had placed on the process and the security provided by the protections contained in the State law. Often residents do not believe any statements of an owner or its representatives. The mediator validated the explanations of the park owner.

An interesting twist in this process was the fact that the residents had their own internal mediator (an assistant city attorney from a different city).

This internal mediator's first task was to narrow down the differing goals and agendas presented by each of the 117 households. He was then able to focus the residents on possible solutions that were feasible and reasonable.

By the end of the mediation, residents learned an important fact. The value of their house can be dependent upon the value and desirability of the location and the land. Previously the residents thought that the value of their property was only based upon the in-place rent controlled value of the house.

The retired judge gave the residents a crash course in real estate and economics as well as help them to better understand State law.

By the end of the one-day mediation most of the residents realized that they would be protected as well as having the possibility of sizable economic benefits when the city approved the conversion/ subdivision.

As more and more cities approve mobilehome park subdivisions, it is interesting to focus on why, while not entirely painless, it is increasingly achievable and always profitable.

The answer is twofold.

First, cities are finally recognizing that they must comply with State law, which severely limits their authority and their control over mobilehome park conversions. Already one city (Palm Springs) ended up paying a nearly \$1 million settlement because of its wrongful delay of a subdivision.

Second, many residents are realizing that the city must approve the subdivision and, therefore, they should participate in the process to maximize their goals – rather than merely fighting the process.

And lastly, park owners are realizing the sometimes you need to give a little to get a lot. No pain, no gain.

Ask the Experts!

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CONVERSION: THE BEST SOLUTION FOR YOU?

BY RICHARD H. CLOSE, ESQ. AND SUSY FORBATH
LAW FIRM OF GILCHRIST & RUTTER

There are several areas of the mobile-home park business that financially plague park owners. Rent control, loss of land value, exit strategy options are all issues for which traditional industry solutions provide inadequate and frustrating answers.

If any of these aspects of the business have proven financially exasperating for you, then the ultimate solution may be a subdivision of your park, otherwise known as conversion to resident ownership. There is a State statutory method by which parks are subdivided into individual lots. The lots are then sold at market value to the residents.

Market value of the lots depends on the location of your park and the value of "stick built" homes in the area. A four or five star park in a desirable location worth \$80,000 per space as a rental park can be worth \$200,000 per space when subdivided. In other words, a 200-space rental park worth \$16 million could be worth \$40 million when subdivided.

A park is converted by a one-lot subdivision with a condominium overlay through a tentative tract map ("the Entitlement Process"). To encourage park conversions to resident ownership, State law restricts the ability of cities to place expensive conditions on the subdivision. Cities must approve the subdivision if State rules are followed. Although this rule has been challenged, the courts have continued to uphold park owners' rights in this area.

After approval by the city and by the California Department of Real Estate ("DRE"), residents have an opportunity to purchase their lot at its fair market value. The buyers also obtain an undivided interest in the park's common areas (the clubhouse, recreation facilities, roads, etc.).

No resident is required to buy his or her lot. They may stay and continue to rent their space from the park owner.

Upon the sale of the first lot, local rent control is replaced by State rent control. For non-low income residents, State law provides that the preconversion rents will



Pictured with Richard Close (center) are Attorney Thomas Casparian and Senior Paralegal Susy Forbath.

be raised to market level in equal increments over a four-year period. After that, there are no restrictions on the rent.

For low-income residents who decide not to purchase their lot, their rents will increase annually by the Consumer Price Index (CPI). If a low-income resident wants to purchase their lot at its market value, the State has a financing program (MPROP) that provides a loan up to 95% of the price at an interest rate of 3% amortized over 30 years. In many cases the loan payments are deferred until the resident sells the home and lot. Under this State MPROP program low income residents often buy their lot and pay less each month than their existing rent.

When a non-purchasing resident later sells his or her home, the buyer must buy the lot from the park owner at its market value. In this manner, the entire park will eventually become resident owned. In the meantime, you as the owner of the unsold lots continue to realize the increased land values of those lots.

Cities and counties benefit from the increase in property tax revenues, which is generated as lots are sold. Also the subdivision of the park eliminates rent control litigation between owners, residents and municipalities because local rent control no longer applies to the property.

When parks transition from rental to resident ownership, cities and counties are still preserving affordable housing while

providing the opportunity for residents to have a choice between affordable rental or purchase housing.

Conversion provides residents with the opportunity to acquire an ownership interest in the park, which certainly would not otherwise occur. So why do certain individuals oppose conversions? Non-low income residents who do not want to buy their lots do not like the fact that under State rent control their rents will increase to market.

However, many seniors and young families residing in mobile home parks want the opportunity to purchase their lot. Senior residents see the purchase as enhancing the value of their home and having an asset to pass on to their heirs. Young families see it as the only way they can have an investment in California real estate that they otherwise could not afford.

Because there is no certainty of the current law remaining unchanged, some park owners are subdividing their parks now with the intention of selling lots in the future. Obtaining entitlement now through a vested final parcel map, secures your future ability to recapture the market value of your land.

While not the best option for every mobilehome park, for the right owner and park, a subdivision/conversion is the solution that benefits the park owner, the residents and the city in which the park is located. It is a win - win - win.

Editor's Note:

Attorney Richard H. Close and Senior Paralegal Susy Forbath are with the law firm of Gilchrist & Rutter in Santa Monica. They focus on mobilehome park issues including acquisition and sale, financing, failure to maintain claims, regulatory and rent control litigation, with a specialization in subdivisions. Richard H. Close was the lead attorney in the El Dorado v. Palm Springs case that established the right of owners to subdivide their parks. (www.gilchristutter.com)

Gilchrist & Rutter has successfully litigated more subdivision challenges than any other law firm in the State.

News for Mobilehome Park Owners

The Five Most Common Rent Control Mistakes, *Continued*

Yet, local ordinances and guidelines also often contain procedural hurdles and pitfalls that can result in a denial of any increase. For example, many will not allow one dollar of capital improvement pass-through without prior approval of the residents. Some require different levels of resident support if the capital expense is for a new item than if it is replacement of an existing item, or no resident approval if it is a government-mandated expense. Knowing the rent control rules in detail before any money is spent may be critical to whether the cost can be recouped, how much can be, and whether it can result in a permanent rent increase or only a temporary pass-through.

Capital improvement treatment is only one example of the importance of knowing the details of a particular rent control scheme. However, it deserves its own listing as a common rent control mistake:

- **See every major repair or improvement as an opportunity.** Many jurisdictions provide for “automatic” rent increases in an amount equal to CPI (or some percentage), and too many park owners fail to seek additional rent increases they may be entitled to, such as for capital expenses. Often, it can be unclear

whether an item is an operating expense or a capital improvement, e.g., street slurring. As stated above, the proper treatment under local rules can make a big difference, and it is not always immediately clear which treatment results in a better outcome for the park owner.

In fact, every expenditure should be seen through rent control glasses. The difference between performing an expensive repair, or several unrelated smaller repairs, in December of one year or January of the next can make the difference between no rent increase or a substantial one depending upon a year’s total operating expenses where loss of NOI must be shown for an increase. But in some jurisdictions, performing accumulated repairs in a single year will be treated as a capital expense and entitle the owner to only a temporary pass-through!

- **Even though the local rent rules result in no rent increase or a small rent increase, you may be entitled under law to much more.** Just because local law may provide only for an “automatic” increase, if you are not earning a fair return on your investment you are entitled to more. Many jurisdictions explicitly recognize the right to a fair return irre-

spective of the rent rules, and some provide for an alternative rent increase process where the owner believes that application of the usual local rules will result in denial of a fair return. But even if they don’t, the law still guarantees this right and the city will either have to review the claim or a court will.

- **When necessary, seek review by the courts.** Many cities routinely flout their own written rent rules, interpret them in absurd ways or make rent determinations based on political convenience rather than the evidence. Seeking a writ of mandate allows the courts to check local government to ensure it is following local, state and constitutional law and that its decision is supported by substantial evidence. The court performs a legal review of the documents and testimony which were already before the local government. Because its determination will be based only on oral argument and written briefs without new evidence, pre-trial discovery or depositions or a jury trial, it is far less expensive than traditional litigation. Even one additional dollar of increase will more than pay for the effort.

Sacramento Legislative Update – Senate Bill 23, *Continued*

Residents at the Hearing focused their advocacy on mandatory brush clearance, fire hydrant inadequacy, lack of accessibility to secondary exits, and the need for better communication between management and residents. The residents were very apprehensive of any mandated code standards for older home safety upgrades, and urged tougher standards for new home construction.

Officials from the County of Los Angeles Fire Department, after receiving much criticism from park residents of their evacuation methods, expressed their concern for the situation and explained that they do not have authority to enforce current standards to existing parks. They testified that increased hydrant inspection and mandatory brush clearance were within their authority.

Representatives for the Department of Housing and Community Development acknowledged that they do not have the manpower to conduct annual inspections, and expressed concern over the confusion created when local agencies assume jurisdiction.

We anticipate that the increased public awareness of this issue combined with the forthcoming change in legislation will in turn create an increase of local agency inspections that may create legal liability for park owners. This Bill would not prohibit a local agency from enacting an ordinance to adopt more stringent standards to ensure fire prevention.

To prevent liability, provide added protection for your park and residents, and to avoid raising any red flags upon inspection, we recommend that park owners/management

get ahead of the curve by:

- Having on-site managers conduct semi-annual brush inspection and clearance both within the boundaries of the park as well as the outer perimeters;
- Having both emergency preparedness and evacuation plans for your park. Make sure that management is familiar with the plans, that every resident has a copy of the plans, and that the plans are posted or available in several locations throughout the park (clubhouse, laundry room, office, etc.);
- Having management keep a record of residents that may be physically challenged or non-ambulatory, or need medications, to provide to emergency response personnel;
- If the park has a secondary emergency exit, provide key or access code to all local emergency response agencies (police, fire, paramedic).