

July 23, 2015

Mayor Tom Bates and  
Members of the City Council  
City of Berkeley  
2180 Milvia Street,  
Berkeley, CA 94704

We are appealing the decision of the Zoning Adjustments Board regarding 2631 Durant Ave, to approve the demolition of 18 relatively affordable controlled rental units and replace them with 56 units of newly constructed market rate rental housing, only four of which would be made affordable to people with low income. *We do not necessarily oppose development, nor even the construction of a 56-unit building on this site.* However, as written, the decision effectively allows the demolition of controlled rental units without properly making the findings required by the Demolition Ordinance, and invites speculators to lay waste to Berkeley's older rental properties for the purpose of obtaining a permit to replace them with new construction.

This appeal challenges the decision on four independent grounds.

1. The applicant can make a fair return; **the revenue projections used by staff were erroneous and based upon a misrepresentation of the number of rooms in each unit.**
2. The ZAB failed to carefully consider the **serious detriment to the affordability** of Berkeley's housing stock caused by the loss of 18 units that were rented for only 65% of median rent.
3. The "voluntary rent control" condition **is unenforceable and not what ZAB approved.** Permanently affordable units would be a more adequate and reliable replacement.
4. The applicant **systematically destroyed the building** by emptying it and allowing it to sit vacant, ignoring the blight ordinance and multiple city warnings to secure the building against trespassers, **inviting the fire department to knock down walls and chainsaw holes in the roof**, all for the purpose of gaining a permit under the demolition ordinance. **This brazen approach to real estate speculation must be discouraged.**

The decision can be remedied by remanding it to the ZAB for new determinations on the first three points. Alternatively, the council could require the applicant to incorporate more

affordability into the project, by replacing the controlled units with permanently affordable units, which would eliminate the harms that the Demolition ordinance is designed to prevent.

**1. The Applicant Can Earn a Fair Return By Rehabilitating the Building.**

The Findings and Conditions state:

*“The Zoning Adjustments Board finds the applicant cannot make a fair return on investment by rehabilitating and maintaining the dwelling unit as a part of the rental housing market because the financial pro forma analysis demonstrates the rate of return would be below acceptable rate of return.”* (Finding IV. E.)

The Demolition Ordinance requires that in order to demolish controlled rental units, the ZAB must find (among other things) that the applicant cannot make a fair return by continuing to rent the units. The reason for this is to ensure that controlled rental units are not demolished unless it is prohibitively expensive to repair them.<sup>1</sup> In 30 years, the ZAB has never found that a property owner could not earn a fair return on the rental market. Obviously, this is because the rental market in Berkeley is extremely lucrative, even more so now than ever before.

In this case it is untrue that the applicant cannot make a fair return by repairing the units, and the ZAB’s determination that the applicant could only earn a 4% return was based on false information provided by the applicant and accepted outright by staff. The applicant asserted that the building contains 10 studios, seven one-bedrooms, and a single two-bedroom. This assertion is contradicted by the records on file with the Finance Department, the longstanding use of the building, the records of the Rent Board, and even filings signed under penalty of perjury by the applicant. This assertion is demonstrably false, and effectively lowers the applicant’s projected revenue by 50%.

The truth is that the building consists entirely of units containing three rooms or four rooms. However, due to the applicant’s deliberate efforts to destroy the building before receiving

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<sup>1</sup> There was some confusion about this at the hearing. For example, the applicant stated at the hearing that “the rate of return in a sense is irrelevant. Because even to rehab this building you still need a demo permit.” This statement is misleading – a permit to demolish the rental units is distinct from a permit to conduct work that would amount to a technical demolition of the building but replace the units as originally constructed. In the latter case no new certificate of occupancy is issued.

permission to demolish it, many of the interior walls have been knocked down. According to the Building Official, “throughout the building, staff noted that openings had been created at the interior walls by removal of finishes and/or framing members, such that most areas of the building were now contiguous.”<sup>2</sup> **Incredibly, the applicant invited the Fire Department into the building to conduct training exercises** during one of the rainiest Decembers in Bay Area history<sup>3</sup>, **and they used chainsaws to cut numerous holes in the walls and roof.** This wanton destruction may explain how the applicant was able to get an appraiser to state that despite the fact that the building contained eight two-bedrooms, nine one-bedrooms, and one studio for over thirty years, the building had suddenly been reconfigured to contain *sixteen fewer rooms*.

Planning Department staff stated that they did not know that the units were designated as 2 BR and 1BR units rather than 1BR and Studio units. They asserted that they first learned of the distinction on the evening of the hearing. This is demonstrably false. First, it is obvious from the text of the staff report that at some point during its drafting, staff believed that there were eight 2BR and ten 1BR units, but then staff later changed the designation. See Staff Report, page 7. Second, the memorandum from the Rent Board’s Executive Director (received June 10, 2014) explicitly states the bedroom count of each of the units. Staff elected to ignore the records of two other city departments and accept representations made by a person who examined the building after the removal of finishes and framing members from the interior walls. This was an error and must be rectified in order to allow the ZAB the opportunity to render a decision based on accurate information.

Without changing any of the assumptions that the applicant provided, and simply using the real number of bedrooms in the building, as listed on the applicant’s Vacancy Registration forms (signed under penalty of perjury on June 11, 2013) the applicant’s return on investment jumps dramatically. According to the Planning Department staff report and statements at the hearing, comparable rental rates are as follows: \$2,698 for a 2BR; \$1,692.27 for a 1BR; \$1,418.61 for a studio.

According to the ZAB staff report, a fair return would be 6-7%. This standard is completely arbitrary and unsubstantiated, opening it up to legal challenge. For contrast, see the CBRE’s

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<sup>2</sup> Memorandum from Alex Roshal to Eric Angstadt, January 30, 2015 “Building Official Determination Regarding Demolition of 2631-2637 Durant Ave per BMC Section 23C.080.070A”

<sup>3</sup> CBS5 News “Wettest start to December in Bay Area History: 736% of normal rainfall in San Jose, 424% of normal in San Francisco” December 17, 2015 [<http://tinyurl.com/kcwqs5b>]; According to USClimateData.com, December saw 12.02 inches of rainfall, 2.4 times the normal 5.04 inches.

2014 Cap Rate Survey for 2014, which found Return on Cost for the San Francisco Bay Area ranged between 3.75% to 4.25%<sup>4</sup>. Even so, using the number of bedrooms the applicant swore existed in 2013, and the rents that Planning staff chose as comparable rents, the return on investment is 6.3%. Therefore the decision on this permit should be remanded to the ZAB, where the permit should be denied, pursuant to Section 23C.08.030E. However, as discussed below, an alternative in which the loss of rent controlled units is fully mitigated could also rectify the situation.

**2. The ZAB failed to carefully consider the serious detriment to the affordability of Berkeley's housing stock.**

To approve a permit under the Demolition Ordinance, the ZAB must find (among other things) that the demolition will not be materially detrimental to the housing needs and public interest of the affected neighborhood and the City. This ensures that the interests of the developer and the future residents of the project are not the only interests considered in granting the permit.

A careful review of the ZAB staff report, the transcript of the ZAB hearing, and the Findings and Conditions, reveals very little consideration of the detriment caused by the demolition of 18 relatively affordable rental units and replacing only four of them with affordable units. These 18 units were rented at approximately 65% of the median price for the area. That means that they were less than half the price of more expensive units, and cost as little as one third of the price of the most expensive units in Berkeley. Such affordability is rare in Berkeley, and must be protected.

By way of comparison, 65% of the median annual income in Berkeley is slightly less than \$41,000, or \$3,416/month. That means that the household's **gross income is less than the average rent for a new 2BR unit in 2014**.<sup>5</sup> Even new studios rent for \$2,239/month, more than twice the rent for 1BR units at 2631 Durant before the property was emptied by the owner. Granted, this is primarily student housing, but the housing affordability crisis has squeezed students, too. **Replacing 14 affordable units with unaffordable market rate units may be in the interest of the wealthiest students, but it is directly against the interest of the students who need it most, and even those students whose families are middle class.**

Comment [1]: can we get some demographic information about Cal students?

<sup>4</sup> CBRE Cap Rate Survey First Half of 2014, published by the CBRE Group, the world's largest real estate investment manager. <http://www.cbre.us/fortlauderdale/AssetLibrary/Cap%20Rate%20Study%20First%20Half%202014.pdf>

<sup>5</sup> BAE \*Draft\* City of Berkeley Affordable Housing Nexus Study, dated March 25, 2015, page 4.

None of these factors were raised in the staff report<sup>6</sup> nor discussed by the ZAB. It may be true that we need more density, and that the building being proposed here would be a welcome addition to the neighborhood. But the ZAB cannot gloss over the requirement that they evaluate the housing needs of the neighborhood and the city. **Replacing affordable rentals with unaffordable new rentals**, even three times as many of them, will not relieve the supply crisis and will not mitigate the detriment to the 14 households who will neither be able to live in the 4 affordable units<sup>7</sup> nor in the 52 unaffordable ones.

**Comment [2]:** Can we quote some authority for why they should have not ignored this? “Despite being given the highest priority in the Housing Element...”

### 3. The Findings and Conditions Do Not Reflect What ZAB Voted to Approve.

At the ZAB hearing, “rent control” was mentioned by the applicant, the Board, and staff, 49 separate times. The applicant stated “It is the applicant’s intention to put the units under the control of the Rent Stabilization Board under the identical rules and terms of the existing units.” In the run-up to the vote to approve the permit, applicant restated the offer as follows: “We are offering to have 20 units be subject to rent control voluntarily be subject to all the authorities that the rent board has. In addition, there are several low income, very low income units that we would be responsible for.”

Rent control includes three essential components. First, there must be a formula for determining the rate at which rents can increase. The proposed Findings and Conditions mentions such a formula.<sup>8</sup> Second, there must be protection against eviction. Tenants in new construction generally have eviction protection under the Rent Ordinance. Third, there must be an enforcement procedure allowing tenants to contest excessive rent increases. *This crucial enforcement provision is completely lacking from the proposed Findings and Conditions*, and creates a substantial gap between what the ZAB approved (as well as what the applicant promised) and how the proposed Findings and Conditions would bind the applicant and future owners.

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<sup>6</sup> A single paragraph was devoted to this finding, and limited its analysis to “a purely housing supply perspective”. Increasing the supply of housing through infill development alone will not mitigate the loss of affordability.

<sup>7</sup> One of the affordable units will most likely be occupied by the state-mandated on-site manager, because that person is paid only \$18,000 per year according to the applicant’s pro forma.

<sup>8</sup> Condition 54, Findings and Conditions page 14.

The Costa-Hawkins Rental Housing Act quite explicitly states that “an owner of residential real property may establish the initial and all subsequent rental rates for a dwelling or a unit [if] It has a certificate of occupancy issued after February 1, 1995.” Civ. Code §1954.52(a)(1) New construction, even where it replaces a demolished building, results in new certificates of occupancy. Therefore, the Rent Board is preempted by state law from regulating rental rates at the proposed 56 unit project that would result from the demolition of 2631 Durant.<sup>9</sup>

Perhaps Planning and Development could enforce the proposed Findings and Conditions by ordering the owner to cease operating the business for violation of the use permit, but this seems far-fetched and was apparently rejected by staff during the hearing. When asked how the Planning department enforces terms incorporated into a permit, staff stated “I guess we could say you are violating the use permit and do normal enforcement. Usually enforcement means, like if it was a business operating outside the zoning ordinance rules, we would say you need to change your operation or we would try to shut the business. Here we wouldn't necessarily do that because that would mean kicking someone out, but like other enforcement cases we would bring it in front of the board, perhaps.” This statement could be reasonably summarized as follows: “we do not know how we could enforce this, if at all so we probably won't.”

We do not believe that ZAB set a condition of approval with the understanding that enforcement would be infeasible. Instead, a review of the transcript reveals that the applicant continually and repeatedly refuted the idea that the rent control condition of approval would be limited *in any way*. Comments by Zoning Board members show an understanding that tenants would have the right to enforce the rent restrictions. However, the gulf between the understanding of staff regarding enforcement and the representations made by the applicant has led to a decision that reflects only the City Attorney's (much more limited) proposal for restricting rent, rather than a fully enforceable condition that (in the applicant's words) would be “subject to all the authorities the rent board has.” Therefore the Findings and Conditions do not reflect what was promised, nor what was agreed to by the ZAB.

#### **4. The Neglect and Destruction of Rental Property for the Purpose of Obtaining a Demolition Permit Must Be Discouraged.**

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<sup>9</sup> If the applicant were to mistakenly raise the rent by an amount exceeding 65% of CPI, or if the applicant were to sell the property to a purchaser who deliberately raised the rents in excess of 65% of CPI, there would be no mechanism by which the Rent Board could enforce the proposed Findings and Conditions of this permit.

To reward the applicant for unpermitted demolition of interior walls by granting a permit to further demolish what remains of the structure creates a terrible precedent and invites other property owners to engage in the deliberate destruction of their older rental property as a form of arbitrage. By acquiring occupied rent-controlled properties, and then removing the tenants and destroying the building to the point where the number of bedrooms is unrecognizable, property owners can simultaneously drive up the cost of rehabilitation while driving down the potential revenue from the existing units by degrading them from two bedrooms to studios. **This brazen approach to real estate speculation must be discouraged rather than rewarded by granting permits that would otherwise not be granted.** An unbiased analysis of the facts coupled with the plain meaning of Finding IV.E. clearly shows that the applicant did not meet his burden to prove that demolition is necessary in the present case. If we want development that provides benefits to the entire community we should not set a precedent lowering the bar to the lowest possible rung.

Given the lengths to which the applicant was willing to go in order to obtain a demolition permit, it may be time for substantial revisions to the Demolition Ordinance. In December 2011, the City Council directed staff to prepare a new ordinance that allowed demolitions in exchange for one-for-one replacement of the units to be demolished. That was and still is sound policy<sup>10</sup>; if it were in place, this particular situation would likely have been avoided.

### **Conclusion**

The decision should be remanded for three independent reasons. First, it should be remanded for a re-examination of whether it is impossible for the applicant to make a fair return, using realistic revenue figures based on the actual number of rooms. Second, it should be remanded for a determination of whether more affordable units are necessary to mitigate the loss of relatively affordable controlled rental units. Third, it should be remanded due to the disparity between the weaker rent increase restrictions found in the Findings and Conditions as compared with the “exact same rules and controls” as existing rent control that the applicant promised to the ZAB. In the alternative, if the units to be demolished were replaced with permanently affordable units, our concerns would be moot.

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<sup>10</sup> One issue not discussed at the ZAB and perhaps somewhat tangential here is the protections necessary to ensure that tenants are not displaced by their landlord for the purpose of obtaining a demolition permit, among other protections. However, it should be noted that all of the tenants in this building were told that they would have to move out, due to the owner’s representation that the property would certainly be demolished.