

DEBITS & CREDITS

Passthroughs 101

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Recoup the costs of capital improvements, operating and maintenance expenses, and utilities with passthroughs.

Are you a landlord in San Francisco? If so, then pay close attention. As a landlord, you have properties with units that either fall under rent control or units that can be rented out at market rates. If you are part of the latter, then you have got to be feeling pretty good right now as rents have been soaring. For those who are not so lucky and have tenants that are taking advantage of your rent controlled units, there is no need to feel as if all hope is lost. There are various ways to make strides toward closing the gap between what you are currently receiving per unit and what you could be earning. Taking advantage of rent increases with the following petitions and passthroughs can help you increase your monthly cash flow AND have your property appreciate. The processes for filing the forthcoming petitions and passthroughs are complex; however, they can be submitted flawlessly with adequate records and the proper assistance.

Each of the following petitions and passthroughs will have their own explicit purposes and procedures for implementation. In particular, landlords should focus on but not limit themselves to the Capital Improvement Petition, the Operating & Maintenance Expense Increase, and the Utility Passthrough. The above were selected because of their benefits, practicality, and likelihood of you having the qualifying circumstances that enable a landlord to impose these rent increases. In the end, implementing any combination of the petitions and passthroughs could aid in getting you to the rent you should be earning.

Capital Improvement Petition

Capital Improvement Petitions are one of the most advantageous petitions to consider because they are based on work that adds value to the property by extending the useful life of the building, component by component. Such work includes, but is not limited to: exterior painting, roof replacement, energy conservation (such as insulating attic space or weather stripping doors), and seismic work that is required by law. While repair and maintenance work are not eligible for the Capital Improvement Petition, they may be used in an Operating and Maintenance Expense Petition, which will be explained later. Capital improvements result in increased intrinsic value of the property and longer useful life. After submitting the petition, the work gets paid for by your tenants, which is a good thing for landlords. Your property will likely be worth more on the open market than before the improvements. The extended life of the building after the work could possibly help at tax time by prolonging and increasing the depreciation deduction of the capital improvement expenses.

As a landlord who may be considering capital improvements, have a plan in place to maximize the effect when filing the petition. To be given due consideration, the rules require landlords to file the petition within five years of the work being done and completely paid off. Completing multiple capital improvements within a five-year span can help a landlord maximize the increase in their monthly rental cash flow from aggregating the costs into one pass-through petition. An additional bonus of this petition is that landlords are not restricted to the tenant's anniversary date for this rent increase, which means it may be implemented at any time. It is imperative that landlords take caution and give proper notice to their tenants about the increases to avoid unwanted disputes.

Keep in mind that work deemed unsafe, unhealthy or that would leave the unit uninhabitable during the improvement process, requires that the tenant vacate the unit. However, the work cannot extend past three months unless a landlord files for the Landlord Petition for Extension of Time for Capital Improvements. Landlords are on the hook for paying relocation expenses for tenants; for specifics, refer to Section 37.9A of the Residential Rent Stabilization and Arbitration Ordinance. Receiving more time to complete the work would entail a landlord proving the reasonableness for the request. Once the work is complete, a tenant has 30 days from receiving the notice of completion to let the landlord know if they want to reoccupy the unit; if they accept, the tenant has 45 days from when they received the notice to reoccupy. You might get lucky; due to their age, stage in life, or personal circumstances, not all tenants will move back in. And—presto—you have a new tenant paying market rent.

Operating and Maintenance Expense Petition

Granted that the 1.6% (2018) allowable annual increase does not even cover inflation, this inequity will leave landlords looking for an answer. One potential answer is to consider levying an additional rent increase through the Operating and Maintenance Expense Petition, which may apply to expenses including but not limited to repairs, maintenance, garbage, water, pest control, etc. To qualify for the Operating and Maintenance Expense Petition, the overall operating expenses for your property must have increased more than the additional annual allowable increase of 1.6% in a 12-month period.

While gathering information for the petition, the landlord must provide proof of their expenses with a 24-month comparison. (Back to keeping "adequate records," I hope you are all using an accounting software like QuickBooks or getting help from a bookkeeper.) Even though the maximum increase for this petition is only 7%, which may not seem like much, it still gets you closer to market rates. When allocating the per unit increase, a landlord needs to account for both commercial and residential units in the building, not just the residential units. Improper allocation could lead to an undesired dispute. Another important note is that property taxes and debt service (mortgage) expenses are not allowed to be passed to the tenants for any building purchased after April 3, 2018 or application filed with the Rent Board after December 11, 2017.

Utility Passthrough

Landlords who pay for a tenant's gas or electricity are permitted to pass on the dollar for dollar amount of increased cost in these utilities to the tenants. The Utility Passthrough would apply to tenants who have lived in the unit for one continuous year. Failure to discontinue the passthrough after 12 months can lead to disputes with tenants and them filing for a reimbursement for overpayments. Receiving assistance from a bookkeeper or knowing how to use a program like QuickBooks is a potential method of avoiding this problem.

A landlord would file a Rent Board Petition for Approval of Utility Passthrough or a Utility Passthrough Calculation Worksheet depending on the tenant's base year. The Petition for Approval of Utility Passthrough is used for tenancies beginning in 2007, 2012 or 2017 and will be assigned the base year of 2016. The Utility Passthrough Calculation Worksheet will be used for tenancies with base years ranging from 2012 to 2015. Filing the wrong form can cause disputes with tenants or denial of submissions.

A landlord should consider the Utility Pass-through because it translates to the full amount of the increase in utility costs from the base year to the comparison year. Meaning that by just filing and being granted this petition, you would be alleviated from directly paying the increased utility costs. Keep in mind that the passthrough is allocated on the total number of rooms in the building, suggesting that each unit may not be designated the same amount as another. As mentioned earlier, wrong allocation of the passthrough can lead to disputes or refusal of submission. In the end, you as the landlord will not be responsible for paying extra costs, thus increasing the rent you are collecting, which will get you closer to those market rates.

Filing Information

When implementing any of the three petitions or passthroughs mentioned above, there are common rules to know. Tenants are not required to pay potential rent increases at the time of the initial notice. They can wait for the approval of the Rent Board; however, the increase is retroactive, meaning if the tenant decides to wait, then they would be responsible for the increase from the date on the initial notice. On one hand, a landlord does not have to wait for the approval of the petition before notifying tenants of rent increase. On the other hand, landlords ought to avoid sending the notice before the Rent Board receives the petition, otherwise the notice becomes void.

Note that each petition and passthrough has its own set of protocols, so it may become unclear which should be applied, and how. Landlords should consult the San Francisco Rent Board about the regulations and any assistance needed with completing any of the petitions or passthroughs. Before considering filing any of the suggested petitions above, a landlord must be organized and have the appropriate information readily available. Due to the complexity of the filing process, it is highly recommended that you get help collecting the proper paperwork and completing the forms. The last thing you would want to do is to go through all the work only to be told it was done wrong. Save yourself that time and hassle, get it done right, and continue to maximize the value of your rental properties.

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