THE
COOPERSMITH
LAW FIRM

July 7, 2021

**Via Email Only**
Molly Chase
Senior Director of Policy
San Diego Housing Commission
1122 Broadway, Suite 300
San Diego, CA 92101
mollyc@sdhc.org

**Re: Proposed SRO Ordinance Amendment**

Dear Ms. Chase:

I represent the Single Room Occupancy Alliance (the "Alliance") in the above-referenced matter. This letter responds to your correspondence dated June 22, 2021, but also is intended to begin a substantive discussion about practical and legal defects in the proposed ordinance currently under consideration to regulate those properties which are considered Single Room Occupancy (SROs) under California and local law.

SROs have been woven into the fabric of this City for many decades. Many of the members of the Alliance have owned and managed their properties for 30 years or more. Like the SDHC, the Alliance seeks to provide affordable, safe, and quality homes for low-income families and individuals in the City of San Diego and aims to offer opportunities to improve the quality of life for those the SDHC serves. The Alliance is committed to working through the complex issues involved in providing affordable housing to extremely low and very low income[1] residents, including many veterans, seniors, and those who suffer from mental or physical illness, substance abuse, and disabilities. In particular, the Alliance is proud to serve so many members of the large San Diego population of veterans within their tenant community. My clients are committed to their tenants, and to this City.

It is important to provide context to this current effort – as the saying goes, there is nothing new under the sun. In 2004, the San Diego Housing Commission (SDHC) recognized in a memorandum concerning changes to SRO regulations proposed at that time that SROs "provide some of the City's most affordable housing inventory," and that "this housing stock has served the most vulnerable and lowest income brackets of our City's residents, including those on fixed incomes such as seniors and disabled individuals." [SDHC Report No. LU&H 04-003, p.2.] According to that report, the proposed changes to SRO regulations back in 2004 were designed to "ensure a sufficient stock of SRO rooms." The SDHC convened a working

[1] As those terms are defined in current Area Median Income (AMI) charts. For convenience, we will use the term "low income" to apply more generally to SRO tenants in this letter.

group during the summer of 2003, and after six full months of planning, discussion, and negotiation, the working group created proposals, but its proposals were rejected, and various City agencies took over. Id., at p.3.

It is apparent that, despite its good intentions, the SDHC's attempt to regulate SROs by placing restrictions on owners has not been successful. A *Voice of San Diego* piece in March 2019 entitled: "Looming SRO Closure Sets Off Another Round of Soul-Searching Over Housing's Bottom Rung," noted that as of that date, there were about 100 SRO properties citywide, with about 5,000 rooms, and yet there were once nearly 5,000 units in downtown San Diego alone back in 1988.[2] We believe that simply adding to the restrictions you decided to place back in 2004 will not lead to any fix to the larger problem, and indeed is more likely to displace SRO tenants and lead to blight in the neighborhoods where SROs predominate. Putting a Band-Aid on a problem by shifting burdens to property owners may be expedient and politically attractive, but we want to engage in a discussion about why it is more likely to fail than succeed.

As you have acknowledged, my clients are important stakeholders in this matter. They are indeed – stakeholders in this community, stakeholders in the success of their tenants, and stakeholders in the future of low-income housing in San Diego. The SDHC **claims** that SRO owners have been directly involved in the process of considering yet another round of regulations, but unfortunately, they have not been consulted in a meaningful way. They have witnessed and lived the daily difficulty of owning and managing properties – many of which have been designated as historic – while the SDHC plans more changes that my clients know will lead to less SRO units, not more.

SRO owners voluntarily serve a public interest, and in return are asked to bear a disproportionate share of the burden of a public entity. SROs – particularly those designated as historic or built many decades ago – are often in dire need of renovation. Unfortunately, the SDHC's approach is to **further restrict** SRO property rights and discourage renovation, which will have the unintended effect of increasing blight, and displacing more residents.

In essence, my clients fully recognize and appreciate that *but for* some SRO properties, tenants at the lowest end of AMI may be homeless, and yet the SDHC has chosen to make it more difficult to operate an SRO, and less attractive to own.

We appreciate the complexity of the problem, and recognize that there are no easy answers. While we appreciate that the SDHC chose to respond to my client's March 1, 2021

[2] https://www.voiceofsandiego.org/topics/government/looming-sro-closure-sets-off-another-round-of-soul-searching-over-housings-bottom-rung/. The reduction of SRO units notwithstanding the SDHC's heavy regulations is well documented. See also, from the *San Diego Union-Tribune:* (1) https://www.sandiegouniontribune.com/news/politics/sdut-homeless-single-room-occupancy-ordinance-2015apr18-story.html; (2) https://www.sandiegouniontribune.com/news/columnists/michael-smolens/sd-me-smolens-homeless-20190322-story.html; and (3) https://www.sandiegouniontribune.com/news/politics/sdut-sro-single-room-occupancy-homeless-hotel-2016feb06-story.html.

letter, we respectfully believe the SDHC is focused on its proposed changes to the exclusion of a creative, thoughtful approach that needs to be discussed and analyzed in continuing working groups with all stakeholders actively involved. So we ask that the SDHC seriously consider the Alliance's input.

Moreover, the proposed ordinance, if adopted, will be susceptible to a range of legal challenges and will almost certainly lead to more displacement of these low-income residents, as well as costly and time-consuming litigation. This is an issue we all wish to avoid and believe that the Alliance and SDHC can work together to achieve this goal.

We have specific concerns about certain parts of the regulations you do propose, and we hope a continuing discussion will be beneficial to all concerned. But as I have noted, the Alliance has an **overall** concern about the direction of the proposed new regulations, and seeks a more thorough, thoughtful discussion about other avenues and proposals, including de-regulation for a period of time, which we believe will lead to increased renovation, incentives to ownership, and more SRO units, providing more opportunities for low-income housing for these important members of our community.

## Practical Objections to Proposed Ordinance

The Alliance has practical and fundamental fairness objections to the SDHC's proposed ordinance. These are by no means an exhaustive, complete set of my client's objections, and should not be taken as exclusive to other concerns we have. We set forth these issues in the hope of having a meaningful discussion with the SDHC and other community and City stakeholders. We remain cautiously optimistic the SDHC and this City administration will hear our concerns, rather than to simply move forward with blinders on to the reality of placing more regulation on SRO properties.

### (1) Sections 143.0507 and 143.0509 – Administration of SRO Hotel Regulations and Administrative Decisions Regarding SRO Hotels

Section 143.0530 of the current SRO regulations provides the SDHC with certain oversight responsibilities. The Alliance is concerned that the proposed Section 143.0507[3] and Section 143.0509 will endow the SDHC with oversight and control beyond its reasonable purview. Specifically, the Alliance objects to Section 143.0507 granting the SDHC authority to administer the process for each final determination as to SRO hotels and to Section 143.0509 granting the SDHC power to make *final determinations* regarding the numerous administrative matters outlined therein.

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[3] It is unfortunate that the SDHC's "Summary of Proposed Changes" on its website does not fully describe additional substantive changes in the proposed ordinance.

**(2) Section 143.0514(a) – SRO Hotel Preservation; Intent to Sell**

**and**

**(3) Sections 143.0511 and 143.0514(c)–(d) – Housing Replacement Requirements; SRO Hotel Preservation; Rehabilitation Financing and Receiver Site**

The Alliance appreciates the fact that the SDHC removed the proposed right of first refusal included in the draft ordinance. We think that is a step in the right direction. And yet keeping the requirement that SRO owners provide 180 days of notice for a proposed sale will lead to serious problems – some you may not even recognize.

As I will describe below, there are serious legal defects in placing a restriction of this kind on property owners. But the 180-day notice requirement does not make logical sense, and ignores the realities of the market for commercial or multi-family properties.

Most potential buyers for an SRO property would be a seller of owned property under an Internal Revenue Code (IRC) 1031 Exchange. The 1031 Exchange concept allows a literal swap of property. By its very definition, the SDHC's proposed ordinance will eliminate any 1031 Exchange buyers from even the possibility of purchasing SROs.

A seller of property who is seeking a 1031 Exchange is also a buyer. Let's call that person a "1031 Buyer," as they must **identify** property or properties to purchase and thus swap with property they just sold, within 45 days of the close of their own sale. This means they are actively in the market and seeking property to buy, immediately. They must then **close** a purchase on the identified property or properties they want to swap within 180 days.

If a 1031 Buyer approaches an SRO owner, and the SRO owner explains the requirement that even the **notice** of that proposed sale must be made for 180 days, that will eliminate that 1031 Buyer from even the logical possibility of purchasing the SRO. In essence, by eliminating all 1031 Buyers, the SDHC's proposed ordinance would narrow the pool of prospective buyers to only the tiny percentage of multi-family properties who would not be 1031 Buyers.[4]

And yet even a potential purchaser who is not a 1031 Buyer would find the 180-day notice of sale requirement a non-starter. Potential buyers of SRO properties – whether under a legally-required time frame like 1031 Buyers, or those who are simply in the market for a multi-family investment property – are looking to purchase, not to be told to come back in 180 days. Markets change dramatically in that period of time, and the 180-day requirement appears to be an arbitrary choice without basis in the practical reality of the relevant market.

[4] Further, the number of buyers interested in SROs are already limited given the substantial restrictions the SDHC has already placed on them.

Likewise, we do not believe the SDHC would want a non-profit developer involved in the purchase of SRO properties – based on the experience of my clients, that would result in a **reduction** of SRO units, which would displace the very tenants we want to protect.

This is a good example of why leaving SRO-owner stakeholders out of a meaningful discussion is short-sighted – the realities of the market dictate problems that more regulations simply do not fix. This increases the public burden SRO owners already bear, and will prevent more SRO units. The SDHC is effectively taking away a primary real estate allowance that would otherwise be permitted under the law.

You note that SRO owners may obtain "funding for the preservation of affordable properties either through a dedicated preservation NOFA or through a traditional NOFA." Once again, this does not consider the realities of the market. As a practical matter, and with limited exception, NOFAs are not generally accessible to SRO owners. Successful NOFA applicants are generally those with dedicated grant writers who have resources and specialized knowledge. Moreover, NOFA recipients must conform to specific HUD property requirements which are not practical or reasonable for SROs, particularly those which are historic-designated or older properties.

The SDHC's proposed regulations do not encourage renovation. In fact, the SDHC is proposing to **increase** regulations on the renovation of properties at the exact time it should be encouraging renovation. Many of these properties were built at a different time, and for a different use. Many SRO properties are in great need of renovation. Some properties have nearly century old pipes, or steam heating or another antiquated system, or elevators well over a half-century old.

Consider the owner of an SRO that has been historic-designated. The SDHC should make it easier, not harder, to renovate these properties. With an historic designation, changes to items like windows or doors, just by way of example, require special fabrication of each new window or door, which costs a significant amount – sometimes about $2,000 per window. With hundreds of windows, renovation would already be a costly proposition, but new regulations would make it counter-productive to even consider a renovation, even one that is much-needed.

These properties also need to be updated to increase the number of electrical outlets (given modern needs for any tenant), and to be maintained and refurbished over time, but the SDHC's proposal would discourage any SRO owner from even attempting a renovation. **Under the SDHC's proposal, even adding a bathroom to one SRO unit, taking that unit out of service, would make the entire property subject to restrictions for 30 years.**

Why would the SDHC seek to discourage renovation and SRO ownership? SRO owners want to be able to serve their tenants and increase the attractiveness of an SRO to a low-income prospective resident, but the SDHC is making it more difficult to do exactly that.

Again, we urge the SDHC to consider alternative proposals and other avenues to encourage more SRO units, rather than less.[5]

**(4) Section 143.0512(e)(2) – SRO Hotel Tenant Relocation Requirements; Financial Assistance**

We appreciate the SDHC's explanation of the proposed SRO resident relocation payments. We respectfully disagree that this will provide solution the SDHC seeks, and moreover will, once again, discourage more SRO units, and will lead over time to more diminution of SROs as a viable option for low-income housing in San Diego.

SRO owners are already bearing a significant public burden. The SDHC seeks to further burden these owners by forcing them to pay a substantial out of pocket expense to relocate tenants who have resided in the SRO hotel for a least 90 days prior. As such, the SRO owners have no incentive to convert or rehabilitate their property, which in turn becomes significantly devalued. Again, no incentives for SRO owners will lead to blight and displacement of SRO tenants. We urge the SDHC to consider the reality of the inherent problem, and work with us to prevent that result.

Under the Proposed Ordinance, owners who merely wish to improve the conditions of a single unit could be required to pay the tenant up to *five times* more than the tenant paid to the owner in rent. For example, some of the SROs charge their tenants $550 per month. If the tenant resides in the SRO for three months (and pays his rent on time), he will have paid the owner $1,650 during the 90 days. If the owner then chooses to renovate that tenant's unit such that it displaces the tenant, he will be required to pay the tenant at least $6,330. Further, if the individual involved is a "special needs tenant" (as many are in SROs that charge such a low rate), the owner would be required to pay $8,320.

In your June 22 letter, you have not explained **why** SRO owners should bear the sole responsibility for making these payments. The Alliance is committed to assisting residents with relocation, but opposed to the SDHC's attempt to force SRO owners to bear the cost of the City's burden towards its low-income and disadvantaged population. In addition to the legal defects, to be discussed below, shifting this burden is inherently unfair and disregards the City's, and other stakeholders, own necessary responsibilities. The San Diego community as a whole is responsible for the well-being of its residents, and the burdens should thus be at least shared for relocation payments.

## Legal Objections to Proposed Ordinance

We hope that the SDHC will consider the practical and fairness objections we have, and engage us in a meaningful conversation towards real solutions to the crisis this City faces in the provision of low-income and affordable housing to this community. Please know, however, that my client is investigating our legal objections to the ordinance, to the extent the

[5] Similarly, the SDHC is doing nothing to encourage the building of **new** SRO properties.

SDHC moves ahead without this crucial discussion. The proposed restrictions have significant legal defects that could mire this City in costly, time-consuming litigation.

As you know, governments are not permitted to take private property for public use without payment of just compensation. The proposed regulation, if enacted, will constitute a "taking" under the Fifth Amendment to the U.S. Constitution and Article I, Section 19 of the California Constitution.

Property ownership provides the owner a bundle of rights, which includes, among other things, possession, use, and dispossession. Gregory v. City of San Juan Capistrano, 142 Cal. App. 3d 72, 88 (1983) ("The constitutional guaranty securing to every person the right of 'acquiring, possessing, and protecting property,' includes the right to dispose of such property in such innocent manner as he pleases.") (citations omitted)); *see also* U.S. v. General Motors Corp., 323 U.S. 373, 378 (1945).

The proposed ordinance is, under current law, a "regulatory taking."[6] Penn Central Transportation Co. v. New York City, 438 U.S. 104, 124 (1978); *see* Kavanau v. Santa Monica Rent Control Bd., 16 Cal. 4th 761, 775–76 (1997) (including and expanding for California law the principles which the U.S. Supreme Court described in the Penn Central case for regulatory, rather than "physical" takings).

In Penn Central, the Court set forth a case-by case, fact-specific determination of regulatory takings through an examination of: (1) the regulation's economic impact; (2) the extent of interference with investment-backed expectations; and (3) the "character" of the governmental action, including intrusion, nuisance, and retroactivity. *See* Arkansas Game & Fish Commission, 568 U.S. 23, 38-39 (2012) (listing factors relevant to the character of the regulation); *see also* Thomas W. Merrill, The Character of the Governmental Action, 36 Vt. L. Rev. 649 (2012).

The Penn Central factors alone are enough to place the SDHC's proposed ordinance in legal jeopardy. As described above, the ordinance, if enacted, would have a detrimental economic effect on SRO property owners, would substantially interfere with the expectations these owners have had regarding the ownership, renovation, and potential sale of their private property, including significant intrusions on their private property rights, and would be a potential nuisance for the community at large.

In addition, given that the proposed ordinance restricts the sale of property already owned, it would be retroactive to their ownership rights. SRO owners, like all property owners, purchase property in the view that it is a salable, valuable investment asset.

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[6] Meanwhile, the U.S. Supreme Court has continued to **expand** the definition of a physical taking. Cedar Point Nursery v. Hassid, 594 U.S. ___ (2021) (characterizing a regulation providing for temporary access rights by labor organizers onto private farmland for recruiting purposes as a physical taking). In an opinion decided just days ago, the Court in Cedar Point showed its intent to refine the law, and quite clearly opened the door to a *per se* consideration of otherwise regulatory takings. *See* Cedar Point, 594 U.S. at pp. 11-16 (Slip. Opn.), Breyer dissenting. It appears this area of law is decidedly in a state of evolution.

Restricting their rights after the fact is not only unfair, it is illegal and will not ultimately stand up to legal scrutiny.

Further, the California Supreme Court in the Kavanau case further expanded and explained the Penn Central factors, including whether the regulation: (1) interferes with reasonable expectations of what it means to own property; (2) affects the existing or traditional use and thus interferes with a property owner's "primary expectation"; (3) is "reasonably necessary" to effect a substantial public purpose; (4) affects the heart of the property owner's holding; (5) transfers the burden of "uniquely public functions"; (6) permits the property owner to obtain a reasonable return and profit on investment; (7) mitigates the financial burden with other benefits to the owner; (8) prevents the "best use" of the land; (9) extinguishes a "fundamental attribute of ownership"; and (10) means the government is demanding the property as a condition of continuing use or permitting. Kavanau v. Santa Monica Rent Control Bd., 16 Cal. 4th at 775–76.

The proposed ordinance touches on nearly every single one of the Kavanau factors. In the midst of an affordable housing and homeless crisis, the SDHC would essentially be transferring the City's public burden to assist and house the community's lowest income members, retroactively, upon existing property owners. Notably, "the Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar [governments] from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." Armstrong v. United States, 364 U.S. 40, 49 (1960).

Through severe restrictions on renovation, the SDHC is preventing the "best use" of the land and demanding unreasonable commitments as a condition of simply continuing to operate an SRO property. Moreover, no one would contest that the right to sell or transfer one's own property is a "fundamental attribute" of ownership. Yet the 180-day notice would directly interfere with an SRO property owner's reasonable and meaningful right to sell. Through the use of arbitrary time limits, the SDHC has unwittingly eliminated all but a tiny portion of potential buyers, given the impossibility of any 1031 Buyer purchasing the property. This quite obviously diminishes value, and leaves SRO property owners in a Morton's Fork quandary.[7]

Further, the Proposed Ordinance prevents SRO owners from a reasonable return on their investment and does nothing to provide them with benefits and rights that would mitigate the financial burdens the SDHC intends to impose. *See, e.g.*, Lockaway Storage v. County of Alameda, 216 Cal. App. 4th 161, 184-186 (2013) (holding that a county's measure temporarily suspending a development project was a regulatory taking).

[7] A Morton's Fork refers to the 15th Century Archbishop of Canterbury's justification for a tax, in that those who are living frugally must have saved money to pay the tax, and those living less frugally must have money to spend. The SDHC's proposed ordinance is not so different – we regulate SROs and yet there are less units, so we must increase regulations of SROs to add units.

Indeed, the replacement requirements in the Proposed Ordinance mean that tenants must be displaced for renovation and would force SROs into situations where they are unable to operate at all. Those properties with historical designations will be unduly burdened by these requirements, given the high cost for any such renovations. The SDHC is effectively depriving SRO owners of their right to use their property while forcing them to pay for rehabilitation.

The Lockaway Storage case is instructive here, just by way of example. A developer intended to develop certain property as a storage facility, and the County of Alameda's measure interfered with its intended use. The First District Court of Appeal found this was a regulatory taking, in that the developer "had already spent significant resources committing its property to that specific use" and "would have incurred substantial costs to convert the property to another use after the County had shut it down," leading to a "material decrease in value." Lockaway Storage, 216 Cal. App. 4th at 185; *see also* Ali v. City of Los Angeles, 77 Cal. App. 4th 246 (1999) (affirming an SRO owner's inverse condemnation claim based on a delay on a demolition permit). Although the SROs would continue in the same use here, the substantial interference with renovation, operation, and meaningful sale would lead to substantial increased costs and a likely material decrease in value. At trial, an economic expert would put numbers to this decrease, but the facts are otherwise apparent.

The SDHC directly references the Ellis Act, codified as California Government Code Sections 7060 through 7060.7. Please note that we are also investigating defects in the City's *ability* to further restrict SRO property owners, particularly in light of the effect of AB 1217. To the extent a legal challenge is made to this proposed ordinance, you are on notice that the City's ability to so regulate will be under scrutiny.

In addition, we note that proposed ordinance Section 143.0510 would require **daily logs** regarding the occupancy status of SRO rooms, and would require a written annual report to the SDHC summarizing tenancy and term of occupancy. We believe that in addition to further shifting the public burden to private property owners, this requirement could also affect privacy rights of tenants, as well as SRO owners. We urge the SDHC to be particularly mindful of my clients' tenant's civil rights as individuals, and to ensure protection for this vulnerable population.

In sum, if the Proposed Ordinance is enacted, we have good reason to believe it will result in a blight in our neighborhoods, and displacement of SRO tenants. The Proposed Ordinance will significantly increase the cost of operating an SRO and discourage investment in these aging assets. Further, it would penalize SRO owners who try to improve the living conditions of these assets and the lives of its tenants. The SDHC is essentially telling SRO owners to stop further investment and improvement and restricting the ability for SRO owners to transfer or sell their asset to a new property owner who may be interested in adding SRO units. This proposed ordinance fails in terms of fairness, constitutionality, and impact on the community it allegedly seeks to protect. It represents a significant step away from fulfilling the SDHC's mission. Although we believe the SDHC has good intentions, the **result** of these proposed restrictions will be negative overall.

The legal analysis above is merely the beginning of our substantive review in this complex area of the law. We present it without exclusion of other issues we are investigating and developing in our review of the proposed ordinance. We also have good reason to believe there are significant and unintended negative economic effects the proposed ordinance will have, and which the SDHC should analyze.

We thus call for a formal economic impact study, given the disincentives to SRO ownership or refurbishment we have addressed above, and the need to get this right at a time when homelessness and the lack of affordable housing in our city has reached a critical level.

According to the most recent SANDAG Regional Housing Needs Assessment (RHNA), San Diego region totals for recent development of moderate, low and very low units is at a tiny percentage of allocated amounts. For example, in the "very low" category, there were 36,450 units allocated, and only 4,206 permits issued. Accordingly, we further recommend that the SDHC commission a specific needs assessment for SRO properties from a group like the Terner Center for Housing Innovation, at UC Berkeley.[8] In our opinion, the SDHC needs to determine best practices for SRO properties, and to understand trends in this region and throughout the country, before simply adding regulations.

While these issues will not be resolved quickly or easily, we ask for a substantive response to this letter not later than **August 1, 2021**.

**We also ask that you postpone further movement on the proposed ordinance so that you can study the issue further and engage in a discussion with us about how to move forward, smartly and thoughtfully.**

We look forward to working with the SDHC and all community and government stakeholders to further address and engage in a meaningful discussion to reform the current law – nearly everyone agrees the current restrictions have not been a success. My clients are committed to this community, and are active participants in the effort to protect low-income residents and assist in solutions to the myriad of problems currently affecting SRO properties.

Thank you in advance for your close attention to this matter and consideration of the issues we raise.

Very truly yours,

THE COOPERSMITH LAW FIRM

Steven Coopersmith
Steven Coopersmith (Jul 7, 2021 12:17 PDT)

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[8] *See*: https://ternercenter.berkeley.edu/research-and-policy/