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October 15, 2020

Los Angeles City Council
c/o Office of the City Clerk
City Hall, Room 395
Los Angeles, California 90012

Attention: PLUM Committee

Dear Honorable Members:

REPORT ON VACATION RENTALS ORDINANCE; CF 18-1246

On December 19, 2019, the City Planning Commission considered an ordinance to allow Vacation Rentals, short-term rentals in non-primary residences. The City Planning Commission recommended approval of the ordinance with modifications. These modifications were:

- Increase the citywide cap from 3,625 (the equivalent of 0.25 percent of the housing supply) to the equivalent of 1 percent.
- Change the geographic unit subject to concentration caps from Census tracts to community plan areas, and increase the cap from 0.25 percent to 1 percent.
- Increase the maximum number of days per calendar year a Vacation Rental may be rented from 30 to 90 days.
- Specify a 250 foot separation, per block face, between Vacation Rental units in Type 1 buildings.

The Commission also instructed City Planning to report to your Committee on the following four items:

1. Study the feasibility of requiring applicants to supply documentation verifying Vacation Rentals are second homes, not investment properties.

The proposed Vacation Rentals Ordinance requires owners of Vacation Rentals to “submit an affidavit, under penalty of perjury, stating that the owner resides in the dwelling unit for which a Vacation Rental permit is being obtained on an occasional or intermittent basis.” This requirement was included in the ordinance in order to help ensure that Vacation Rentals are limited to second homes (i.e. homes that are lived in by the owner) at least occasionally, and therefore, unavailable for long-term housing in order to minimize the impact of Vacation Rentals on housing available for Angelenos.

However, since the efficacy of an affidavit is contingent on the veracity of the information provided by Vacation Rental permit applicants, it could be circumvented by those seeking to obtain Vacation Rental permits for units they do not occasionally occupy. In response to this concern, the City Planning Commission instructed City Planning to explore whether there are additional methods of verifying occasional owner occupation of Vacation Rental units, and of verifying that second homes, not investment properties, are used for Vacation Rentals.

City Planning has studied the issue, and, in summary, has found that two Federal tax forms can be used to demonstrate occasional owner occupation of Vacation Rentals. Additionally, these forms can be used to distinguish true *second homes*, from properties that are not used by their owners on at least an occasional basis, referred to as *investment properties* for the purposes of this report.

According to the IRS, a secondary property is considered a *home* if it is used for personal purposes for more than 14 days or 10% of the days it is rented to others at a fair rental price per year. An *investment property* is a secondary property which is not used for personal use in excess of these thresholds. The IRS requires owners of secondary properties to file one of two forms (Schedule A or Schedule E) depending on two factors: if the property meets the IRS standard for what is considered a home, and if the property is rented to others at fair rental price for 15 or more days per tax year.

Schedule A-Itemized Deductions form (1040 or 1040-SR)

Schedule A forms are filed for *homes* that are not rented to others at fair rental price in excess of 15 days per tax year. The IRS does not consider the primary function of these types of units to be revenue-producing rentals, but rather true homes. Filing a Schedule A form satisfies the need to verify occasional owner occupation of the unit, and could also be used to verify that a unit is a *second home*.

Schedule E-Supplemental Income and Loss from Rental Real Estate (form 1040 or 1040-SR)

Schedule E forms are required to be filed for two types of secondary properties: *investment properties* and *second homes* that are rented to others at fair rental price for more than 15 days per tax year.

Schedule E forms require taxpayers to list both the number of days the unit was used for personal use and the number of days the unit was rented at a fair rental price. This required information could be useful for distinguishing *second homes* from *investment properties* among Schedule E filers. In particular, information indicating the number of days the unit was used for personal use (more than 14 days for *second homes*) could be used to verify that the owner resides in the building “on an occasional or intermittent basis” as the ordinance requires and comply with the intent of that eligibility criteria.

Below is a table summarizing the circumstances under which a property owner would file either Schedule A or Schedule E forms.

Tax Form	Property Type	Viable Replacement for Owner Occupation Affidavit?	Additional Relevant Filing Requirements
Schedule A Itemized Deductions form (1040 or 1040-SR)	<i>Second home</i> + rented to others < 15 days/tax yr	Yes	N/A
Schedule E Supplemental Income and Loss from Rental Real Estate (form 1040 or 1040-SR)	<i>Second home</i> + rented to others >=15 days/tax yr	Yes	Disclose number of days unit was used for personal use, and number of days rented at a fair rental price.
	<i>Investment property</i>	Yes	

Both the Schedule A and Schedule E tax forms can be used to not only demonstrate owner occupation of Vacation Rental units, but also whether or not a unit is used as a second home. Should the PLUM Committee wish to limit Vacation Rental activity to units that qualify as second homes, requiring these forms at the time of permit application would allow for such vetting to occur. Applicants could still be required to submit an affidavit stating that they are compliant with the occupancy requirements established in the ordinance, however this would require the following modification to the Section 12.22.A.34(c)(1):

(1) **Permit Application.** To register for a Vacation Rental permit, an applicant shall file an application with the Department of City Planning in a manner provided by the Department, and shall include: information needed to verify the ownership of the unit proposed for Vacation Rental, and applicant's identification; an affidavit, signed and submitted under penalty of perjury, stating that the applicant ~~resides in~~ uses the Dwelling Unit for which a Vacation Rental Permit is being applied for personal use on an occasional or intermittent basis for at least 14 days a year; Schedule A or E Federal tax forms from the previous year; identification of a local responsible contact person and his or her contact information; a list of all Hosting Platforms to be used; and any other information required by the instructions on the application. On the Vacation Rental permit application, the applicant shall acknowledge and consent to the Office of Finance and other City agencies' inspection of records at all reasonable times and places for purposes of enforcement of this Subdivision. Payment of any filing fee required under Section 19.01 U. shall be included with the application. If the required information for registration, including any filing fee, is not received within 45 days of submittal of the application, the Vacation Rental registration application will be considered withdrawn.

2. Study the feasibility of limiting properties eligible for Vacation Rentals to those owned by individuals and individual trusts, not limited liability corporations (LLCs).

Under the proposed Vacation Rentals ordinance, “no person or entity may apply for or otherwise operate more than one Vacation Rental at a time in the City.” The inclusion of the word “entity” in this provision allows for limited liability corporations (LLCs) and other ownership structures to be used for obtaining Vacation Rental permits. The CPC, however, instructed City Planning to investigate ways to prevent LLCs from obtaining Vacation Rental permits, and to restrict permit eligibility to just individuals and individual trusts.

The City’s Home-Sharing Ordinance, which regulates short-term rentals in primary residences, restricts host eligibility to just individuals, so there is precedent for this requirement, and a similar approach can be taken to regulate Vacation Rental permit eligibility. One immediate step that could be taken to eliminate LLCs from obtaining Vacation Rental permits, while allowing for individuals and individual trusts to obtain them, is to replace the provision in the proposed ordinance stating that “no person or entity may apply for or otherwise operate more than one Vacation Rental at a time in the City” with “no individual or individual trust may apply for or otherwise operate more than one Vacation Rental at a time in the City.” It is important to use the term “individual” rather than “person” in this provision, and throughout the Vacation Rentals Ordinance, because “person” has a definition in the Tax Code that includes “company, joint stock company, business trust, domestic or foreign corporation, association...or any group of individuals acting as a unit...” While this change alone does not solve the issue, it is a necessary step that must be taken in order to limit Vacation Rental permit eligibility to individuals and individual trusts.

A second step in preventing LLCs from obtaining Vacation Rental permits that could be taken is implementation of enhanced application and eligibility requirements, similar to those contained in the Home-Sharing Administrative Guidelines. Applicants for Vacation Rental permits could be required to provide documentation that verifies their identity as individuals. The submitted identification materials would have to match the information contained in the permit application in order to move forward. To verify identification, prospective Vacation Rental owners could be asked to submit a valid federal or state issued photo identification such as a driver’s license or passport. In order to verify that an applicant owns the proposed Vacation Rental, owners may be asked to provide documents including a copy of a current property tax bill, insurance bill or policy document, or the Schedule A or E tax forms described in the above section of this report. By requiring such documentation, the issuance of Vacation Rental permits would effectively be limited to real, identifiable individuals, and would prevent LLCs from obtaining permits to operate short-term rentals.

Enhanced application and eligibility requirements would still allow individual trusts to obtain Vacation Rental permits. If an applicant wishes to obtain a Vacation Rental permit for a unit they own through an individual trust, identification materials and documentation demonstrating ownership of the unit proposed to be used as a Vacation Rental could still be required. In this scenario, the trustee would have to provide documentation to verify that they are the trustee of the trust that is applying for the permit, and that they, through the trust, own the unit intended to be used as a Vacation Rental.

3. Study the feasibility of allocating a portion of the Transient Occupancy Tax (TOT) and/or fees collected from Vacation Rentals to support affordable housing, permanent supportive housing, and/or housing for the homeless.

The proposed Vacation Rentals Ordinance requires owners of Vacation Rentals to obtain Transient Occupancy Tax Registration Certificates from the Office of Finance, and “fully comply with the requirements of Article 1 of the LAMC (establishing the Transient Occupancy Tax) and successor sections.” Currently, revenue collected from the Transient Occupancy Tax (TOT) is deposited in the City’s General Fund, which is allocated by the City Council. The proposed Vacation Rentals Ordinance does not propose making any changes to this process, and the allocation of funds collected from the TOT and deposited in the City’s General Fund could be earmarked for affordable housing, permanent supportive housing, or housing the homeless at the City Council’s discretion.

The City Planning Commission also instructed City Planning to report on the feasibility of allocating money generated from Vacation Rental fees for affordable housing and housing for the homeless. Section 8 of Article XIII B of the California State Constitution stipulates that fees issued by cities in order to administer services may not exceed the reasonable estimated cost of providing the service. The Vacation Rental permit application fee has been set at an amount that is reasonably expected to cover the costs of services required to implement the administration of Vacation Rental permits, and therefore, there should not be excess funds available to be allocated for affordable housing or homeless housing provision.

The Vacation Rentals Ordinance also proposes a per-night fee be charged to each Vacation Rental owner, with the funds to be deposited into the Short-Term Rental Enforcement Fund. Funds collected from this fee are intended to cover the cost of enforcing short-term rental (Home-Sharing and Vacation Rentals) regulations. The fees collected for enforcement have been set to an amount that can reasonably be expected to cover the costs of enforcement. Therefore, as in the case with the administrative fee charged for Vacation Rental permit application, extra funding would not be available from this fee that could be used for other purposes.

4. Provide additional information regarding the economic tipping point between a long-term and short-term rental within the construct of other regulatory limitations contained in the ordinance.

In an effort to prevent housing from being taken out of the rental market to be used as Vacation Rentals, and to remove any financial incentive for doing so, City Planning proposed a cap on the number of nights a Vacation Rental is allowed to operate. In order to identify where the financial incentive begins for converting housing to short-term rental use, City Planning researched the economic tipping point for short vs long-term rental profitability. Essentially, this research identified how many nights, on average, the short-term rental of a whole unit would need to be rented to equal the amount of income generated from a year-long lease.

City Planning obtained data on median whole unit short-term rental rates from Host Compliance, the third party short-term rental monitoring company the City has partnered with for Home-Sharing enforcement. Data on median rates of year-long leases, both citywide and in neighborhoods where short-term rental activity is most prevalent, was obtained from the US Census and American Community Survey (ACS). Using this information, City Planning divided the median rate of year-long leases by the median rate for whole-unit short-term rentals in neighborhoods where short-term rentals are most prevalent. This generated a range of 70-85 days as the number of days it would take for a short-term lease to equal the income obtained through a year-long lease (considered the tipping point), depending on the neighborhood.

The nightly cap on Vacation Rental activity was proposed at just 30 days, well below the identified tipping point range, to discourage any conversion of housing units to Vacation Rentals and to account for all markets. However, the City Planning Commission increased the proposed nightly cap from 30 days to 90, and instructed City Planning to report back on whether the tipping point would be impacted by any of the other regulatory limitations contained in the ordinance.

An additional study on this topic was prepared by advocacy group Los Angeles Alliance for a New Economy (LAANE) during the adoption process for the Home Sharing Ordinance in 2016, and the conclusions of that study are similar to the one prepared by City Planning. According to this study, it takes an average of 83 nights per year to earn as much or more from short-term renting a unit than can be earned in a year-long lease.

City Planning also received a study on this issue, sent on January 28, 2020, from Airbnb. This study concludes that the economic tipping point is actually 231 nights - substantially higher than the tipping point identified by both City Planning and LAANE. However, the study is based on data that potentially includes home-sharing rentals rather than solely vacation rental information. This study uses the average listing price for all Airbnb activity in the City to determine the tipping point, rather than only whole-unit listings, which City Planning used in its analysis. Whole-unit listings are considerably more expensive than listings where people can rent a single room or portion of a unit, so the conclusions drawn in this study reflect a higher tipping point than the one City Planning determined. Additionally, the study provided by Airbnb does not use Census or ACS data for median rental rates, and uses Zillow, RentJungle, and ApartmentList instead. RentJungle, the report acknowledges, uses average rental rates rather than median rates, and ApartmentList does not provide analysis at the neighborhood level.

There are many provisions in the proposed ordinance that are intended to limit the prevalence and concentration of Vacation Rentals, including caps on the number of Vacation Rentals allowed to operate citywide, in each community plan area, and in buildings with more than four units (Type 2 buildings), distancing requirements from Vacation Rentals in buildings with four or fewer units (Type 1 buildings), limiting the number of Vacation Rental permits an individual may receive to just one, and prohibiting certain types of housing from being used as Vacation Rentals. However, City Planning cannot reasonably conclude that these measures, either individually or collectively, with the data currently available, will impact the profitability tipping point between short and long-term rentals.

Ordinance Revisions

In response to the City Planning Commission's changes to the proposed ordinance, City Planning conducted a new environmental analysis in the form of an Initial Study and Negative Declaration (ENV-2019-7046-ND). As part of this analysis, City Planning met with representatives from City departments that could be affected by the implementation of the proposed Vacation Rental Ordinance in order to identify any potential enforcement issues. As a result of this exercise, some minor edits were proposed to the ordinance. The proposed edits do not make any substantive changes to policy regarding Vacation Rentals, and are only intended to provide additional clarification. A revised ordinance highlighting these changes has been included as an attachment to this report.

Conclusion

City Planning appreciates the opportunity to provide further analysis of the policy considerations related to Vacation Rentals. If you have any questions, please contact Patrick Whalen in the Department of City Planning at (213) 978-1370 or patrick.whalen@lacity.org.

Sincerely,



VINCENT P. BERTONI, AICP
Director of Planning

VPB:KK:AV:HSC:BK:pw

Enclosures