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Minority Report to Housing and Homelessness' Committee RSO Recommendations

For the minority report of the Housing and Homelessness' Committee recommendation (CF: 23-1134) to move forward recommended changes to the Rent Stabilization Ordinance (RSO), I wanted to take an opportunity to share my thoughts on why the City should be open to a different course of action, offering more potential benefits to both tenants and property owners.

There are multiple issues at stake which have real impact to renters and housing providers. Unfortunately, the issues are complex, and many are being lost in the discussion. The summary below explains the reasoning for the proposal put forward in the Committee's minority report.

Our RSO is premised on the notion that rent stabilized units shall not increase in rent, except for inflation. In other words, they cannot simply raise the rent because the market would allow for it, or someone else would be willing to pay more for the same unit. This is what the RSO is all about. Adjusting for inflation keeps the intent of the RSO intact and maintains the balance between renter and housing provider.

However, a dollar today is not worth the same as a dollar next year, or in any future year. The real cost of rent is the amount one pays adjusted for inflation. It is not a specific dollar amount, but the value/purchasing power of the rent that you pay. So, to charge the very same amount this year as you do next year, you need to adjust the amount being charged/paid for inflation. If inflation is 10% annually, then paying \$1000 rent this year is like paying \$1100 next year. To increase next year's rent to more than \$1100 is to increase the value of the rent above a stabilized level and to charge less than \$1100 is to effectively decrease the value of the rent below a stabilized level. To hold the rent steady or to stabilize it, you need to adjust the rent appropriately for inflation.

The debate about the RSO ordinance is all about-

- How you adjust for inflation;
- How you measure inflation;
- And whether or not you allow any other factors such as the costs of utilities to be independently included in the determination of rent.

How do you adjust for inflation?

The current RSO formula recognizes that rent should only be increased to adjust for inflation. However, the current formula states that, regardless of inflation, rent increases should never be allowed to exceed 8% (rent cap).

Similarly, the current formula states that even when inflation is below 3%, landlords are allowed to charge the full 3% (rent Floor). The rationale for this is that even though inflation is less than 3%, landlords have expenses that rise regardless of inflation. So, in the \$1000 rent example, if inflation is at 1%, landlords would still be able to raise the rent to \$1030, even though the rent should only be \$1010 were it to be only about keeping up with inflation. Tenants argue that this is unfair.

The Housing Department has proposed lowering this rent cap to 5% and the rent floor to 2%. This would be better for tenants because it would prevent a steep rent increase and the dislocations and hardships that come with it. However, it would also lower the value of the rent tenants are paying to below what stabilized rent would be if properly adjusted for inflation (assuming inflation is greater than 5%). In these situations, the RSO law would not be holding rent constant, but actually lowering it. This goes beyond the intent of the RSO and causes a host of other problems (i.e. takings claims, mortgage defaults, housing disinvestment, etc).

The Housing Department proposed a common sense solution to handle this problem while maintaining the benefits of a rent cap. Their solution is called "rent banking." Rent banking allows the City to cap the allowable annual rent increase while at the same time allowing for the landlord to ultimately charge rents that actually track inflation over time. In other words, if in one year inflation is 7% and the allowable rent increase is capped at 5%, then the excess 2% is "banked" to be potentially applied in future years when inflation is less than 5%. In this scenario, if inflation is 3% in year two, the landlord would be permitted to increase rent to 5% that year — effectively 'spending' what was banked on the landlord's behalf.

I have added the concept of 'rent banking' for when inflation is less than the floor. Doing so, allows the tenants to ultimately pay only the rent that tracks with inflation and not let the landlords lock in a rent increase that is higher than inflation simply because it was allowable given the rent floor. In other words, if inflation is 1% in one year and landlords are permitted under the proposal to charge 2% so as to cover their costs, if in year two inflation is 5%, they should only be allowed to charge 4% — effectively allowing the tenant to utilize the inflation decrease that was banked on their behalf.

Banking enables the City to lower the rental increase cap (helps renters), without hurting the long term value of the property and allows everyone to stay true to the principle that rent should remain exactly the same over time, adjusted for inflation. It allows for a lower cap in a way that is more legally defensible as well. So, while the allowable caps and floors prevent big swings in allowable rental increases, banking enables rent to more accurately track real inflation over

time. The net result is a more stable rental market where the actual cost of rent remains constant over the long term.

Rent banking is really important if you believe, as I do, that the whole purpose of the Rent Stabilization Ordinance, is to keep the real cost of rent for tenants stable over time. It is also important because mortgages are based on the value of a building which is based on the rent that will accumulate adjusted for inflation. When you don't allow for the rent to be adjusted for inflation, you risk mortgage defaults and fewer future investments in housing.

While banking might seem complicated, it is not in practice because the City Department of Housing keeps track of what rental increase is allowed each year based on how they calculate inflation and they can easily adjust the allowable increase based on what has been 'banked.' It is not something individual landlords or tenants have to calculate or manage.

In conclusion, the minority report is simply advocating for the Housing Department's proposal with the addition of the 'rent banking' when inflation is less than the rent floor. The Housing Department did back up their proposal with extensive research and analysis. While the floor and caps are important, 'rent banking' is the most important element of the minority report as it allows the City to stay true to the notion that in RSO apartments, rent should not be increased or decreased except for inflation adjustments.

Sincerely,

A handwritten signature in black ink, appearing to read "Bob Blumenfeld". The signature is stylized and written in a cursive-like font.

BOB BLUMENFIELD
Council President Pro Tempore
City of Los Angeles