WORKABLE STANDARDS FOR DETERMINING ALLOWABLE RENT INCREASES IN MANUFACTURED HOUSING COMMUNITIES

Kenneth K. Baar*

A significant number of households in Delaware live in manufactured homes which they own that are on rented lots in manufactured housing communities. Due to immobility of the homes and consequently the peculiar inequality in bargaining power between the land owner and the homeowner associated with such tenancies, in 2013 Delaware passed a "Rent Justification Act," applicable only to this type of tenancy. Under the Act, annual rent increases in excess of the percentage increase in the Consumer Price Index ("CPI") must be justified in an arbitration pursuant to the rent adjustment standards in the law if they are contested by the homeowners. In July 2022, amendments to the Act suspended for five years a portion of the standards for allowable rent increases in excess of the CPI and substituted other standards which sunset in five years and amended other provisions of the Act. This article was substantially completed before the 2022 amendments and addresses the Act's pre-existing provisions, while an addendum briefly describes and comments on the 2022 amendments.

While the standard in the Act for annual allowable rent increases is customary among the manufactured housing community rent legislation which has been adopted in six other states, the standards for setting allowable increases above the increase in the CPI undermine the purposes of the Act. The law mandates the use of rents agreed to by incoming homeowners as a measure of allowable rents for all spaces in a community, subject to a requirement that such increases are phased in. An amendment now in effect for five years exempts new leases of one year or more from the regulation.

I. INTRODUCTION

In Delaware, about 20,000 lots in 182 in manufactured housing communities (commonly known as "mobile home parks") are rented by those who purchased their home, but not the land on which it is placed.[1] These owned homes on rented lots comprise about five percent of the housing units in Delaware.[2] In 2013, Delaware adopted a law known as the "Rent Justification Act" to regulate lot rent increases in these communities.[3] Under the Act, if a community owner seeks a lot rent increase in excess of the percentage increase in the Consumer Price Index ("CPI") and the homeowners object, a determination of the allowable lot rent is made through a binding arbitration process.[4]

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* J.D., Univ. of California, Hastings College of Law; Ph.D., UCLA (urban planning); admitted to the California Bar.

1. Spreadsheet provided by Delaware Manufactured Home Relocation Authority "DEMHRA") to author (Sept. 1, 2021) [hereinafter *DEMHRA Spreadsheet*] (on file with author).

2. *See* United States Census Bureau, *Quickfacts: Delaware*, http://www.census.gov/quickfacts/fact /table/de/pst045221 (last visited Feb. 6, 2022) (Showing 443,781 housing units in delaware as of July 1, 2019).

3. Rent Justification Act, 79 Del. Laws c. 63, § 1 (2013) (codified as amended at 25 Del. C. §§ 7050-7056 [hereinafter the "Act"]); *see also* Bon Ayre Land, LLC v. Bon Ayre Cmty. Ass'n ("*Bon Ayre II*"), 149 A.3d 227, 230 (Del. 2016) (Noting that the Act is commonly known as the "Rent Justification Act"). The Act only applies to lots with manufactured homes owned by tenants and does not apply to lots with homes owned by the community owner (which are covered by the landlord-tenant code). *See* 25 Del. C. §§ 7001(A), 7002(c) (2022). For avoidance of doubt, citations to the Act as adopted in 2013 are cited to the Delaware code, while references to the recently adopted amendments to the Act, discussed in the Addendum, are cited to the statute. *See infra* note 155.

4. 25 Del. C. § 7053. The relevant consumer price index under the Act is defined as the "Consumer Price Index For All Urban Consumers in the Philadelphia-Wilmington-Atlantic City area" or "CPI-U." *Id*. § 7052(a). The amounts of the annual allowed increases are tied to the average annual increase in the CPI-U over the preceding thirty-six months. *Id.*

The purpose of this article is to propose standards for regulating rent increases which are more objective, logical, and consistent with the purposes of the Act. It was written before substantial amendments to the Act were adopted in July 2022. Section II provides background about the ownership of both manufactured homes and manufactured housing communities in Delaware and regulations of manufactured housing community rents in other states. Section III discusses the Act, its interpretation by Delaware courts, some seemingly illogical results arising from these cases, and how the Act's standards for rent increases differ from those of other states. Section IV sets forth suggestions for reform. An addendum to the article discusses the 2022 amendments to the Act.

The intent of the Act is to shield manufactured homeowners from unreasonable lot rent increases and protect their substantial investments in their manufactured homes, while preserving the rights of community owners to obtain a "just, reasonable, and fair return."[5] While the rule authorizing annual rent increases is simple and objective, the application of the standards for determining allowable rent increases above the CPI has been beset with problems.

The process for reviewing proposed lot rent increases in excess of the CPI involves two steps. First a community owner must demonstrate that the proposed lot rent increase is "directly related to operating, maintaining, or improving the manufactured home community."[6] However, the Act does not provide any guidance about the meaning of the term "directly related," and its meaning has been deciphered in widely divergent ways.

In the second step, community owners who satisfy the "directly related" requirement may justify a proposed increase in excess of the CPI increase on the basis of statutorily enumerated factors. Five of the factors relate to the expenses of operating a community, including capital improvements.[7] One factor is "market rent," which is defined as the "rent which would result from market forces absent an unequal bargaining position between the community owner and the homeowners."[8] While the Act lists these possible justifications, it does not provide direction concerning how they should be weighed in determining what rent shall be permitted.

The lack of specificity in the Act has led to vastly differing and diametrically opposite interpretations of its meaning among arbitrators and courts.[9] Faced with vague standards, arbitrators and courts have substantially relied on their consideration of the purposes of the Act, which are also very general, in order to resolve uncertainties as to its meaning. Within the past seven years the Delaware Supreme Court has issued six opinions related to the meaning of the Act.[10] Arbitration and court decisions applying the law frequently include comments about the Act's ambiguity, its lack of sense, and/or uncertainty in the meaning of appellate court guidance.[11]

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5. *Id*. § 7050.

6. *Id*. § 7052(a)(2).

7. *Id*. § 7052(c)(1)-(5).

8. *Id*. § 7052(c)(7).

9. See *infra* text accompanying notes 46-73. In one case, an arbitrator explained that its interpretation was the "only way to logically interpret" the law, only to be reversed on appeal. *Bon Ayre II*, 149 A.3d at 235–36. Apart from struggling with the substantive provisions of the law, on more than one occasion, Delaware courts have also strongly criticized the ambiguity of its procedural provisions and standards of review. *See* Pot-Nets Coveside Homeowners Ass'n v. Tunnell Cos., 2015 WL 3430089, at *5 (Del. Super. Ct. May 26, 2015) (noting that "[a]mbiguity exists within the Act"); Bon Ayre Land LLC v. Bon Ayre Cmty. Ass'n ("*Bon Ayre I*"), 133 A.3d 559 (Table), 2016 WL 747989, at *2 (Del. Feb. 26, 2016) (describing statute as "confusing at best, incoherent at worst"); December Corp. v. Wild Meadows Home Owners Ass'n, 2016 WL 3866272, at *3 (Del. Super. Ct. July 12, 2016) (noting difficulty in interpreting statute whose language "seems to effectively straddle both standards of review"). Another issue has been whether the income and expense information submitted by community owners in order to justify a rent increase is entitled to confidentiality protections. *See* Wild Meadows MHC, LLC v. Weidman, 250 A.3d 751, 760-63 (Del. 2021).

10. *See* Rehoboth Bay Homeowners' Ass'n v. Hometown Rehoboth Bay, LLC, 252 A.3d 434 (Del. 2021); *Wild Meadows MHC, LLC,* 250 A.3d at 751; Sandhill Acres MHC, LC v. Sandhill Acres Home Owners Ass'n, 210 A.3d 725 (Del. 2019); Donovan Smith HOA v. Donovan Smith MHP, LLC, 190 A.3d 997 (Table), 2018 WL 3360585 (Del. July 10, 2018); *Bon Ayre II*, 149 A.3d at 227 (Del. 2016); *Bon Ayre I*, 2016 WL 747989 (Del. Feb. 26, 2016).

11. *See supra* note 9; *infra* text accompanying note 12.

Adjudications under the Act may be characterized as a dance by arbitrators and courts caught between carrying out the purposes of the Act, interpreting the literal words of the Act, deciding what makes sense, and adhering to the principle of judicial restraint. As one arbitrator noted:

> [The Act] allows logical but significantly contrasting arguments to be made by practitioners on both sides of these cases under the Act. In my view, the Act itself needs clarification… These [court] decisions do not explain how a community owner's *return* is computed, nor what *ledger* is involved in the analysis.[12]

More objective and precise provisions would end the need for this dance.

II. BACKGROUND

A. The Nature of Manufactured Home Ownership and Community Ownership

Most manufactured housing community lots in Delaware are concentrated in the larger communities.[13] Consistent with national ownership patterns of manufactured home communities, ownership in Delaware has consolidated in recent decades. Three entities own about thirty percent of the community lots in the state and ten entities own about half of the lots.[14]

Although usually called "mobile homes," as the U.S. Supreme Court explained in 1992:

> Mobile homes are largely immobile as a practical matter, because the cost of moving one is often a significant fraction of the value of the mobile home itself. They are generally placed permanently in parks; once in place, only about 1 in every 100 mobile homes is ever moved .... A mobile homeowner typically rents a plot of land, called a "pad," from the owner of a mobile home park. The park owner provides private roads within the park, common facilities such as washing machines or a swimming pool, and often utilities. The mobile homeowner often invests in site-specific improvements such as a driveway, steps, walkways, porches, or landscaping. When the mobile homeowner wishes to move, the mobile home is usually sold in place, and the purchaser continues to rent the pad on which the mobile home is located.[15]

In the Rent Justification Act, the Delaware General Assembly noted that "[o]nce a manufactured home is situated on a manufactured housing community site, the difficulty and cost of moving the home gives the community owner disproportionate power in establishing rental rates" and that "[t]he continuing possibility of unreasonable space rental increases in manufactured home communities threatens to diminish the value of manufactured homeowners' investments."[16]

Nevertheless, ownership of a manufactured home on a rented space in a manufactured housing community offers significant benefits, particularly for retirees or households with below-average income. Even considering the combination

12. Wild Meadows Home Owners Ass'n v. Wild Meadows MHC, LLC, Consol. Dkt. 10-2017, at 17 (DEMHRA Jan. 21, 2019) (Gibbs, Arb.). All of the arbitration decisions cited in this article are on file with the author.

13. Thirty-eight percent of the lots rented to manufactured homeowners are in sixteen communities that have over 300 spaces; and sixty percent of the rented lots are in communities with 200 or more spaces. *See DEMHRA Spreadsheet, supra* note 1.

14. See *DEMHRA Spreadsheet, supra* note 1; *see also* DEMHRA, Registered Communities as of June 23, 2021 (list of the owner of each community) (spreadsheet on file with author).

15. Yee v. City of Escondido, 503 U.S. 519, 523 (1992) (citing Hirsch & Hirsch, *Legal Economic Analysis of Rent Controls in a Mobile Home Context: Placement Values and Vacancy Decontrol*, 35 UCLA L. Rev. 399, 405 (1988)).

16. 25 Del. C. § 7050 (2022).

of the cost of purchasing a manufactured home and paying rent for a space in a manufactured home community, this form of ownership is often more affordable than owning a single-family home or the combined cost of purchasing a vacant plot of land and installing a mobile home. Manufactured housing communities provide opportunities for households to live in a single family detached dwelling with surrounding open spaces even if a single-family home on a separate lot is unaffordable. Apart from providing affordability benefits, communities commonly contain shared social and recreation facilities and frequently perform as supportive social communities.[17]

As for community owners, investments in owning manufactured housing communities offer significant advantages relative to investments in other types of rental income properties such as apartments, offices, and retail centers. Manufactured housing community operating costs typically fall within thirty-five to fifty percent of rental income.[18] The balance of rental income—net operating income—is available to cover mortgage payments and provide a return on the cash investment. Due to the captive nature of manufactured housing community tenancies, community owners are insulated from the risks of cycles in market demand, vacancies, and declines in rental income.[19] The lack of risk is reinforced by the fact that rentals of community spaces are part of a three-cornered transaction: rents that incoming homeowners are willing to pay are determined in conjunction with agreeing on a price for the home. If there is a steep increase in the rent, the current homeowner must either pay the higher rate or sell the home. Since the home either cannot be moved to another community or can only be moved at a substantial cost, a homeowner desiring to avoid an increase in the ground rent may be forced to accept a lower price from a prospective purchaser, who will offset a substantial rent increase by paying less for the home.

By the 1990s, real estate investment entities came to view communities as very attractive investments, and moved into an industry formerly dominated by small-time owners of individual communities with personal ties to their residents.[20] For decades, real estate newsletters, financial journals, and other commentators have described manufactured home communities as low risk investments offering a host of advantages over investments in apartment buildings.[21] There has been a continual pattern of consolidation of the ownership of manufactured housing communities among large scale

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17. *See* Andrée Tremoulet, *Manufactured Home Parks: NORCs Awaiting Discovery*, 24 J. of Housing for the Elderly 335, 344 (2010) (noting the "personal safety and a sense of community" associated with living in "naturally occurring retirement communities," or "NORCs").

18. Robert S. Saia, Appraising Manufactured (Mobile) Home Communities and Recreational Vehicle Parks 80 (Appraisal Institute 2017).

19. Howard Rudnitsky, *New Life for Old Mobile Home Parks*, Forbes, Nov. 7, 1994, at 44-45 (describing how "owning the ground under a customer's $30,000 investment makes timely collection of rents relatively easy").

20. *See id*.

21. *See, e.g., NAREIT Conference Call Recap*, NAREIT Investor Outreach (Dec. 10, 1999) (investments in manufactured housing communities outperforming other types of real estate investments) (on file with author); Frank Rolfe, *Why Investors Like Warren Buffett are Bullish on Mobile Home Parks*, WealthManagement.com (April 15, 2011), https://www.wealthmanagement.com/investment-strategies/why-investors-warren-buffett-are-bullish-mobile-home-parks (explaining "[t]his locked-in tenant base is what enables park owners to enjoy phenomenally stable revenue figures, even in major recessions."). In 2020, industry sources noted that while the apartment industry was pummeled by the COVID-19 pandemic and rent moratoriums, manufactured housing community occupancy and income levels remained stable. *See* Sebastian Obando, *Institutional Investors Bet on Manufactured Housing as Occupancy, Rents Continue to Grow*, Wealthmanagement.com (Sept. 29, 2020), https://www.wealthmanagement.com/property-types/institutional-investors-bet-manufactured-housing-occupancy-rents-continue-grow.

national investors.[22] Currently, in the U.S. three investment entities each own over 60,000 manufactured housing community spaces.[23]

B. Regulations of Manufactured Housing Community Rents in Other States

Delaware is one of seven states with regulations of rent increases in manufactured housing communities. Three states—New York, Rhode Island, and Vermont—have adopted statewide rent legislation applicable only to manufactured home community spaces.[24] Rhode Island permits manufactured housing community homeowners to seek binding review of a rent increase on the basis that they are "unreasonable based on park owner's…total expenses…"[25] Vermont permits homeowners to seek a review of increases which exceed the CPI increase by more than one percent.[26] Under New York law, adopted in 2021, annual increases in manufactured home community lot rents are limited to three percent, subject to a right to an increase of up to six percent to cover increases in operating costs and capital improvements.[27]

In three states—California, Massachusetts, and New Jersey—local regulations have been widespread since the 1980s. In California, about ninety cities and counties have adopted manufactured housing community rent stabilization ordinances, which are applicable to roughly 150,000 manufactured home community spaces.[28] About twenty-three municipalities in Massachusetts regulate manufactured housing community space rents.[29] According to a 2009 survey, over

22. *See* Ryan Dezember, *Investors Discover There's Gold in the Mobile-Home Park*, Wall St. J., Feb. 26, 2020, at B1-2 (describing acquisitions exceeding $100 million of communities by major investors); *see also* Rupert Neate, *America's Trailer Parks: The Residents May Be Poor but the Owners Are Getting Rich*, Guardian, (May 3, 2015 8:00 AM EDT), https://www.theguardian.com/lifeandstyle/2015/may/03/owning-trailer-parks-mobile-home-university-investment (describing ability of owners to raise rents and plight of residents who have no other options).

23. *See* Patrick Revere, *Top 50 Manufactured Housing Community Owners*, (April 15, 2021), https://www.mhvillage.com/pro/50-top-mh-community-owners-operators/ (listing the number of manufactured housing communities and spaces owned by the top 50 owners).

24. N.Y. Real Prop. Law § 233-B (2021); 31 R.I. Gen. Laws § 31-44.1-2 (2022); Vt. Stat. tit. 10, §§ 6252-6253 (2022) (providing that mediation can be requested if the increase is more than one percent above the CPI increase and arbitration can only be requested if mediation fails). Thirty-six states have preempted local rent regulation ordinances. *See* National Apartment Association, *Rent Regulation*, https://www.naahq.org/advocacy/policy-issues/rent-regulation (accessed Mar. 9, 2022).

25. 31 R.I. Gen. Laws § 31-44.1-2(b)-(c) (2022).

26. Vt. Stat. tit. 10, §§ 6252(a) & 6253(a) (2022).

27. N.Y. Real Prop. Law, § 233B(2), (6) (2022). Increases above six percent must be justified under a "hardship" standard and are limited in duration. *Id*. § 233B(6).

28. *See California MHP Rent Stabilization Ordinances (RSO aka SRSO)*, Mobile Home Park Owners Allegiance, https://mhphoa.com/ca/rso/ (last visited May 4, 2022) [hereinafter *California MHP Rent Ordinances*] (providing a summary of rent increase standards under each local ordinance, the date of adoption, and data on the number of communities and lots in each jurisdiction). Two jurisdictions, Riverside County and San Jose have over 10,000 manufactured housing community lots, and seven other jurisdictions have over 3,000 community lots. *Id*. Given that two of these municipalities have, on their own, half as many lots as Delaware and that the other seven have a substantial number of lots, their legislation may serve as a valuable resource for drafting workable laws. Ordinances which have been adopted within the past decade take into account the fair return precedents of the past few decades and contain more detailed standards regarding fair return and treatment of expenses. *See, e.g.*, Humboldt Cnty., Cal., Cnty. Code, §§ 9101-10 to -12 (2021), https://humboldt.county.codes/.

29. *See* Peter Benjamin, *Mobile Homes, in* Legal Tactics Tenants' Rights in Massachusetts 373, 377 (Annette R. Duke, ed., 2017) (listing cities with regulations of mobile home park rents), https://www.mlri.org/publications/tenants-rights-in-massachusetts-private-housing/.

one hundred New Jersey municipalities have adopted rent control ordinances; at least ten of the ordinances apply only to manufactured housing communities.[30]

With few exceptions, the local ordinances in California and New Jersey authorize annual increases.[31] Usually the amount of the allowable increases is tied to the either the full percentage increase in the CPI or to a portion of the increase.[32] Some of the ordinances place a ceiling on the percentage increase that is allowed under the CPI standard.[33] Under the Massachusetts ordinances, a board is authorized to adopt annual increase allowances.[34]

Apart from the annual allowable rent increases, three types of rent adjustment mechanisms are common among the laws of the other states.

1. *Fair Return Adjustments*. Under every rent regulation owners may obtain rent adjustments in order to be permitted a rent which provides a fair return. Fair return issues and standards are discussed in detail in section V.1.B of this article.

2. *Cost Passthroughs*. A significant portion of the California ordinances allow increases based on "passthroughs" of increases in specified types of operating expenses or capital improvement costs.[35] Commonly, the passthroughs are contained in ordinances that limit annual rent increases to less than the annual increase in the CPI, commonly 60 to 80% of the percentage increase.[36] Generally, passthroughs are limited to capital improvements and types of costs which are beyond the control of a community owner, such as increases in property taxes, other government mandated fees, or utility costs. There is a great deal of variety among the passthrough provisions, including: caps on passthrough amounts; limitations to capital improvements necessary to maintain a community (rather than new facilities, unless approved by a majority of the homeowners); and limits on passthroughs to a portion of capital improvement costs.[37]

Passthrough allowances offer the advantage of simplicity because they do not require consideration of overall income and expense information. On the other hand, they allow for additional rent increases even if the annual rent adjustments and other types of allowable increases are already adequate to cover cost increases and provide a fair return.

3. *Additional Increases Upon In-Place Sales of Mobile Homes*. Another rent adjustment method has been to allow additional rent increases when a manufactured home is sold in-place. About one third of the California ordinances and

30. *See* N.J. Dept. of Cmty. Affs., Div. of Codes and Standards, Landlord-Tenant Info. Serv., *2009 Rent Control Survey* (2009) [hereinafter "New Jersey Rent Ordinances"], https://www.nj.gov/dca/divisions/codes/publications/pdf_lti/rnt_cntrl_srvy_2009.pdf.

31. *See id.*; *California MHP Rent Ordinances, supra* note 28.

32. *See supra* note 31.

33. *See*, e.g., Contra Costa Cnty, Cal., Ordinance Code § 540-2.404(a)(2) (2022), https://www.contracosta.ca.gov/1210/Codes-Ordinances; Borough of Franklin, N.J., Code § 176-18(C)(3) (2021), https://ecode360.com/FR1843; *see generally California MHP Rent Ordinances, supra* note 28; *New Jersey Rent Ordinances, supra* note 30.

34. *See*, e.g., Springfield, Mass., Mun. Code § 16-54(A) (2021), https://ecode360.com/SP2105.

35. *See, e.g.*, Santa Rosa, Cal., City Code §§ 6-66.040(C)-(D) (2021), https://qcode.us/codes/santarosa/view.php (allowing pass through for government mandated expenses and utilities charges); Washington, N.J., Mun. Code § 184-2(A) (2019), https://ecode360.com/WA0294 (including passthrough for supplied utilities); Wall, N.J., Mun. Code § 153-35(B) (2020), https://ecode360.com/WA1959 (including passthrough for major capital improvements).

36. *See, e.g.*, Los Angeles Cnty., Cal., Cnty. Code § 8.57.50(C) (2022), https://library.municode.com/ca/los_angeles_county/codes/code_of_ordinances (limiting annual increase limited to 75% of CPI increase, with a minimum allowance of 3%); *id*. § 8.57.070(D) (passthough of 50% of capital improvement cost).

37. *See, e.g.*, Santa Cruz Cnty., Cal., Cnty. Code § 13.32.030(D)(5)(g) (2021), https://www.codepublishing.com/CA/SantaCruzCounty/ (passthrough of 50% of capital improvement cost).

some of the New Jersey ordinances include this type of provision.[38] Usually, such increases are limited to five or ten percent or a roughly equivalent dollar amount.[39] Limits on the frequency of such increases for the same space are common.[40]

III. DELAWARE'S RENT JUSTIFICATION ACT

The Act authorizes annual increases equal to the percentage increase in the CPI.[41] This approach provides a reasonable balance between the interests of manufactured homeowners and community owners. When both operating costs and rents increase at the same rate as the CPI, "net operating income" increases at the same rate, thereby providing for growth in both income and value. Also, due to typical leveraging aspects of investments in income producing real estate, the returns on actual cash investment are much higher than the rate of return on the total investment.[42]

The Act also authorizes rent increases in excess of the percentage increase in the CPI if the community owner can satisfy three conditions:

> 1) the owner has not been found in violation of any provision of Title 25, Chapter 70 of the Delaware Code that threatens the health and safety of residents that persists for more than fifteen days;[43]
>
> 2) the proposed increase is "*directly related* to operating, maintaining, or improving the manufactured housing community…" *and*
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> 3) the increase is "justified by 1 or more factors listed under subsection (c) …."[44]

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38. *See California MHP Rent Ordinances, supra* note 28; *see, e.g.*, MARLBORO, N.J., TWP. CODE § 235-11 (2020), https://ecode360.com/MA0373.

39. *See California MHP Rent Ordinances, supra* note 28.

40. *See id*.

41. *See* 25 DEL. C. § 7052(a) (2022).

42. For example, if a community is purchased for $5 million with a typical thirty percent (equity ratio) cash down payment of $1,500,000 and a mortgage of $3,500,000, a 30% increase in value from $5 million to $6.5 million doubles the owner's equity from $1,500,000 to $3,000,000. *See* Colony Cove Props., LLC v. City of Carson, 220 Cal. App. 4th 840, 876–77 (Cal. Ct. App. 2013) (noting that "one reason for indexing NOI at less than 100 percent of the change in the CPI" is that "real estate is often a leveraged investment" in which "[t]he investor invests a small amount of cash, but gets appreciation on 100 percent of the value" (quoting Los Altos El Granada Investors v. City of Capitola, 139 Cal. App. 4th 629, 640 (Cal. Ct. App. 2006))).

43. One superior court decision holds that violations of other health and safety provisions do not implicate this provision. *See* Winterset Farms Homeowners' Ass'n Inc. v. Winterset Farms, LLC, C.A. No. N20A-12-010 DJB (Order) (Del. Super. Dec. 29, 2021) (order affirming in part and modifying arbitration order) (holding that violation of county sewer code, despite posing a "significant risk to the public health and welfare," is not a factor in setting rents under the Rent Justification Act, which only refers to violations Chapter 70 of the State Code).

44. 25 DEL. C. § 7052(a)(1)–(2) (2022) (emphasis added).

The third condition's enumerated factors include operating expenses and market rent.[45]

A. Step One – The "directly related" standard

The Act does not specify how to determine whether a proposed rent increase is "directly related" to operating, maintaining, or improving the manufactured home community. The question is critical because, as described below, community owners who satisfy this condition have been able to obtain proposed rent increases with an amount determined solely by the market rent factor, rather than the amount of the "directly related" cost.[46] Thus, an owner desiring an increase to market rent can undertake an improvement at a minimal cost and consequently justify a substantial rent adjustment based on market rents.

Since the adoption of the Act, the lack of a definition of "directly related" has opened the door to a range of radically differing opinions about its meaning among arbitrators and courts, drastically diverging outcomes in rent arbitration hearings, and a lot of litigation. One end of the spectrum in regard to the meaning of "directly related" includes views that a proposed increase may meet this standard if it is connected to a desire to bring rents to market levels,[47] or a desire to undertake capital improvements, or some initial steps toward undertaking capital improvements (as opposed to completing them).[48] A more common concept has been that a proposed rent increase is "directly related" if any capital improvements have been made or there has been an increase in any type of operating cost.[49] In other cases, arbitrators and courts have held that "directly related" means that overall costs, rather than just specified costs, have increased.[50] Others

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45. The subsection (c) factors are:
(1) The completion and cost of any capital improvements or rehabilitation work in the manufactured home community, as distinguished from ordinary repair, replacement, and maintenance.
(2) Changes in property taxes or other taxes within the manufactured home community.
(3) Changes in utility charges within the manufactured home community.
(4) Changes in insurance costs and financing associated with the manufactured home community.
(5) Changes in reasonable operating and maintenance expenses relating to the manufactured home community including costs for water service; sewer service; septic service; water disposal; trash collection; and employees.
(6) The need for repairs caused by circumstances other than ordinary wear and tear in the manufactured home community.
(7) Market rent … [and]
(8) The amount of rental assistance provided by the community owner to the homeowners under § 7022 of this title. *Id.* § 7052(c).

46. *See infra* text accompanying notes 60–70.

47. *Bon Ayre II,* 149 A.3d at 239 (Vaughn, J., dissenting) ("[T]he community owner's desire to bring rents more in line with market rent is directly related to the operation of the community.").

48. *See* Donovan Smith MHP v. KDM Dev. Corp., Dkt. No. 2-2017, at 3 (DEMHRA May 4, 2017) (Rushe, Arb.) ("Furthermore, the Respondent stated they plan on resurfacing the roads but cannot make these types of improvements without a rent increase. This satisfies the modest requirement of producing evidence that suggests that the return on the property has declined."); Ruben v. Bon Ayre Land LLC, Dkt. No. 17-598, at 3 (DEMRHA Sept. 22, 2017) (Kuhl, Arb.) (finding that "an owner may satisfy the first prong [of subsection (c)] with an uncompleted improvement"); *id.* (noting that "I am not deciding that ground must actually be 'broken'" and that "preconstruction preparation can be sufficient, depending on the circumstances."). There was no indication in these decisions that implementation of the proposed increase would be contingent on completing the capital improvement.

49. *See, e.g.*, Sandhill Acres HOA v. Sandhill Acres MHC, Consol. Dkt. No. 4, 2017, at 6-8 (DEMHRA July 17, 2017) (Sharp, Arb.).

50. *See, e.g.*, Subset of Affected Lots in Holly Hill Estates v. Holly Hill Estates, Dkt. No. 6-2017, at 5-6 (DEMHRA Aug. 30, 2017) (Sherlock, Arb.).

have held that in addition to evidence of an increase in overall costs, there must also be evidence that the overall return has been reduced, taking into account revenues as well as costs.[51] In another case, an arbitrator held that "[t]here must be both a substantial relationship and sufficient proportionality between the cost increase and proposed rent increase."[52]

As described below, the Delaware Supreme Court has addressed the disputes about the meaning of the "directly related" standard in four opinions, but has not resolved them.

1. Bon Ayre II

The Supreme Court first addressed the question in 2016 in *Bon Ayre Land, LLC v. Bon Ayre Community Association* ("*Bon Ayre II*").[53] This opinion provided mixed messages concerning the meaning of "directly related." One passage indicates that the application of the Act involves preserving the "initial relationship" between the community owner and the homeowners, taking into account "costs and expected profits."[54] Another passage could either indicate that evidence of an increase in overall costs, without evidence of overall income, is adequate to meet the "directly related" standard or could mean that evidence about the overall return is relevant.[55] A subsequent passage enigmatically states that a land owner need only produce "evidence suggesting" that a "return" has declined, implying that information concerning only one expense would be adequate to fulfill the directly related requirement.[56] One arbitrator, considering *Bon Ayre II*, lamented that "The Supreme Court's opinion restated the Section 7042(a)(2) ["directly related"] analysis at least four times using varying formulations and without specifying a holding."[57]

2. Donovan Smith HOA v. Donovan Smith MHP

Two years later, the Delaware Supreme Court revisited the issue in *Donovan Smith HOA v. Donovan Smith MHP*.[58] The Court restated *Bon Ayre II*'s requirements:

> In *Bon Ayre* … we made clear that "the landowner must show that its original expected return has declined, because the cost side of its ledger has grown. If a landowner can show that its costs have gone up, that opens the door to a rent increase based on § 7042(c)'s factors, including market rent."[59]

51. Wild Meadows MHC, LLC v. Weidman, 250 A.3d 751, 759 (Del. 2021) (quoting Sandhill Acres MHC, LC v. Sandhill Acres Home Owners Ass'n, 210 A.3d 725, 731 (Del. 2019)) ("[B]oth sides of the community owner's financial statements [income and expenses] bear logically on whether and to what extent a rent increase is 'directly related to operating, maintaining or improving the manufactured housing community' under the Act.").

52. Murray Manor HOA v. Murray Manor, MHP, LLC, Dkt. No. 3-2019, at 6 (DEMHRA Dec. 29, 2019) (Lawson, Arb.) (emphasis omitted).

53. 149 A.3d 227 (Del. 2016).

54. *Id*. at 234 ("The Act protects homeowners by preserving the initial relationship between themselves and the landowners, which presumably takes into account the landowners' costs and expected profits.").

55. *Id*. at 234-235 ("[U]nless the landowner has seen its costs increase for 'operating, maintaining or improving the manufactured home community,' the Rent Justification Act preserves the initial relationship the landowner creates between its revenue and its costs …. The homeowner … is protected from material increases in rent unrelated to the costs and benefits of living in the community, and the landowner receives the return it originally anticipated.").

56. *Id*. On the basis of this guidance, an arbitrator held that a plan to resurface roads along with the owner's testimony that the rent increase was needed to cover this cost was adequate to meet the "directly related" requirement. Donovan Smith MHP HOA v. KDM Dev. Corp., DEMHRA, Dkt. 2, 2017, at 3 (May 4, 2017) (Rushe, Arb.).

57. Rehoboth Bay HOA v. Hometown Rehoboth, Dkt. No. 9-2017, at 9 (DEMHRA March 1, 2018) (Spence, Arb.).

58. 190 A.3d 997 (Table), 2018 WL 3360585 (Del. July 10, 2018).

59. *Id*. at *1.

However, this statement does not clearly resolve whether a property owner could rely solely on evidence that the "cost side of [the] ledger" went up or must submit evidence that its overall return has declined, taking into account both increases in operating expenses and rental income.

3. Sandhill Acres MHC, LC v. Sandhill Acres Home Owners Association

The next year, the Supreme Court revisited the "directly related" standard in *Sandhill Acres MHC, LC v. Sandhill Acres Home Owners Association*.[60] In this case, the community owner provided evidence of an expenditure of $12,185 for a new water filtration system and data in support of an annual rent increase of $53,760 based on a market rent justification but did not provide evidence regarding overall costs or income.[61] Once again, the arbitrator, the Superior Court, and the Supreme Court reached divergent conclusions about the meaning of the Act's "directly related" requirement.

The Arbitrator, relying on *Bon Ayre II*, rejected the homeowners' argument that a property owner must provide evidence of reduced profit margins, instead concluding that a community owner could rely solely on evidence of a capital improvement to meet the "directly related" requirement.[62] The Superior Court, also relying on *Bon Ayre*, reversed the Arbitrator's decision.[63] It held that evidence about only one cost, without evidence about overall costs, was insufficient.[64]

On appeal, the Supreme Court, also relying on *Bon Ayre II*, overturned the Superior Court, holding that it "suffices for the community owner to offer evidence that in making some capital improvement, the community has incurred costs that are likely to reduce its expected return."[65] However, it noted that the homeowners could have rebutted a "directly related" claim "by offering evidence … for example … that the expenditure was offset by reduced expenses in other areas," but indicated that in this case the residents failed to request cost information a timely manner.[66] While the court reversed the Superior Court, it agreed with its holding that consideration of "*both sides* of the community owner's financial statements bear logically on whether and to what extent a rent increase is 'directly related to operating, maintaining or improving the manufactured housing community' under the Act."[67]

The Supreme Court also addressed whether and under what conditions a capital improvement expenditure could fulfill the "directly related" requirement when the justification of the amount of the requested annual rent increase was based solely on the market rent factor. The court held that in order to fulfill the directly related requirement: "there should be a material capital expenditure … that has a substantial relationship to the rent increase sought."[68] It explained

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60. 210 A.3d 725 (Del. 2019).

61. *Id*. at 729-30.

62. Sandhill Acres HOA v. Sandhill Acres MHC, Consol. Dkt. No. 4, 2017, at 19 (DEMHRA July 17, 2017) (Sharp, Arb.).

63. Sandhill Acres Home Owners Assoc. v. Sandhill Acres MHC, LLC, 2018 WL 4613716 (Del. Super. Sept. 18, 2018).

64. *Id*. at *5 ("A community owner must show an increase in its costs such that its expected return has declined in order to move to market rent for its existing residents.").

65. *Sandhill Acres*, 210 A.3d at 728-29.

66. *Id*. This case was one of several cases in which burden of proof and procedural issues have been raised and in which the manufactured homeowners have tripped over failures to request information in a timely manner. *See also* Donovan Smith HOA v. Donovan Smith MHP, LLC, 190 A.3d 997 (Table), 2018 WL 3360585, at *3 (Del. July 10, 2018).

67. *Sandhill Acres*, 210 A.3d at 731. To this end, the Supreme Court held that a community owner "must make a choice. Refrain from seeking an increase above inflation and thus be able to keep its information to itself … or … be willing to incur the concomitant requirement to justify that increase." *Id*.

68. *Id*. at 729.

that although the requirement was "modest," it was not "toothless."[69] By example, the court noted that an improvement that cost only $1,000 would not be considered to be directly related to a proposed annual rent increase of $25,000, but concluded that the cost of $12,185 for a water filtration system was a "material percentage of the proposed annual increase" of $53,760.[70] Consequently, by undertaking this very modest expenditure, the community owner was able to obtain a rent increase on the basis of the market rent factor that would garner an additional $268,900 in just the next five year period.

4. Wild Meadows MHC, LLC v. Weidman

Most recently, in December 2021, the Supreme Court reiterated its *Sandhill Acres* holding in *Wild Meadows MHC, LLC v. Weidman*.[71] It repeated that "*both sides* of the community owner's financial statements bear logically on whether and to what extent a rent increase is 'directly related to operating, maintaining or improving the manufactured housing community' under the Act."[72] It explained that such information must be available in order to be able to rebut an owner's prima facie case by demonstrating that an "expenditure did not in fact reflect any increase in costs–for example because the expenditure was offset by reduced expenses in other areas."[73]

Up to now there been a substantial amount of litigation over the meaning of the "directly related" requirement and whether a community owner seeking a rent increase has met this standard. However, in future cases even a more demanding application of the "directly related" standard, such as requiring a showing of an increase in overall costs or a decline in net revenues, may only amount to a speed bump on the way to consideration of the market rent factor. As one arbitrator concluded: "A community owner can tie virtually any expenditure (other than acquisition costs and debt service …) to 'operating, maintaining, or improving' the community."[74] Normal fluctuations in overall expenses, combined with discretion in the timing of substantial maintenance or capital improvement expenditures, can easily result in increases in overall operating expenses and/or downward fluctuations in net operating income which provide a basis for meeting the "directly related" requirement.

Delaware's "directly related" hurdle is unique among rent legislation. Typically, manufactured housing community rent laws provide that once a review process is triggered, it involves consideration of all the factors that are relevant to that review, rather than including an intermediate "directly related" hurdle.[75]

B. Step Two – The Subsection C Factors

Once the "directly related" standard has been satisfied, two aspects of the Subsection C factors raise substantial issues. First, the market rent factor appears to be at cross-purposes to the General Assembly's stated purposes in adopting the Act. Second, it is unclear whether adjudications pursuant to this Subsection should consider of all of the listed factors, or only those raised by a manufactured home community owner in its application.

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69. *Id*.

70. *Id*.

71. 250 A.3d 751 (Del. 2021).

72. *Id*. at 759 (emphasis added) (citing *Sandhill Acres*, 210 A.3d 729).

73. *Id*. at 758 (citing *Sandhill Acres*, 210 A.3d 729).

74. Wild Meadows Home Owners Ass'n v. Wild Meadows MHC, LLC, Consol. Dkt. 10-2017, at 17 (DEMHRA Jan. 21, 2019) (Gibbs, Arb.).

75. *E.g.*, San Jose, Cal., Muni. Code §17.22.700 (2022), https://library.municode.com/ca/san_jose/codes/code_of_ordinances ("all documentation upon which the landlord relied in determining the proposed rent increase … [including] a statement of the operating expenses" must be submitted in order to commence the arbitration process).

1. The "Market Rent" Factor

The market rent factor rests uneasily with the purposes of the Act and its underlying premise that rent increase regulations are necessary to alleviate the outcomes of the unregulated market and to protect homeowners from rent increases that will reduce the value of their homes. The first part of this standard, which was included in the original Act in 2013, defines market rent as "that rent which would result from market forces absent an unequal bargaining position between the community owner and the homeowners."[76]

However, there is no accepted or even common understanding of what market would meet this condition or what methodology could be used to determine such a rent. A host of regulatory constraints govern how the market works and sway the relative bargaining powers of community owners and manufactured homeowners. The concept that one could determine what the rents would be in a market "absent unequal bargaining position[s]" is illusory. One may ask, would this mean: 1) a market in which manufactured homes and communities could be placed anywhere it was safe to do so, without being restricted by zoning rules, or 2) a market in which a significant supply of vacant spaces is available in competing communities, or 3) a market with technology that enabled the movement of manufactured homes from one community to another at a low cost combined with a willingness of community owners to accept homes without age or size restrictions?

The New Jersey Supreme Court once proposed and then withdrew a similar rubric in the context of controls of apartment rents.[77] In 1975, the New Jersey court stated that fair return could be based on the rents in a "*market free of the aberrant forces* which led to the imposition of controls."[78] However, three years later the court noted that "[n]one of the witnesses had performed such an analysis before; none knew of any recognized appraisal method for making hypothetical equilibrium valuations."[79] The court concluded that "a value-based criterion for confiscation under rent control is practically unworkable."[80]

In 2014, the market rent factor in the Delaware Act was amended to provide for consideration of the rents agreed to by incoming homeowners: "In determining market rent relevant considerations include rents charged to recent new homeowners entering the subject manufactured home community and/or by comparable manufactured home communities"[81] *In Bon Ayre II* the Supreme Court described this approach as a "fair way" to consider market rents, "[b]ecause new homeowners have not yet made the investment … and are therefore unencumbered by switching and investment costs that could distort the value of a given location.…"[82] In *Sandhill Acres* the court further affirmed the use of this measure.[83]

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76. 25 Del C. § 7052(c)(7) (2002).

77. *See* Troy Hills Village v. Council of the Township of Parsippany-Troy Hills, 350 A.2d. 34, 44 (N.J. 1975).

78. *Id*. (emphasis added).

79. Helmsley v. Borough of Fort Lee, 394 A.2d 65, 72 (N.J. 1978).

80. *Id*.

81. 25 Del. C. § 7052(c)(7) (2022).

82. *Bon Ayre II*, 149 A.3d at 237-238 (emphasis added).

83. *Sandhill Acres*, 210 A.3d at 730 n.31 (stating that market rent factor serves "not just the interests of community owners" but also "the interests of homeowners by focusing the inquiry on the rent paid by new entrants not subject to the compromised bargaining position of existing homeowners"). The Superior Court had reached the opposite conclusion. Bon Ayre Community Ass'n, Inc. v. Bon Ayre Land, LLC, 2016 WL 241864, at *8 (Del. Super. Jan. 12. 2016) ("allowing an increase based solely on market rent could lead to situations where a homeowner is faced with an unreasonable or burdensome increase in rent even when there is no threat to a community owner's just, reasonable, and fair return on their investment…. [a]llowing a community owner to increase rent based solely on a market rent justification does not balance the rights of the homeowner and the community owner.").

While endorsing this approach on two occasions, in *Bon Ayre II* the court also carefully indicated that the rents charged to new homeowners were not the only "permissible types of evidence" of what would be considered as market rents for the purpose of the Act.[84] Nevertheless, in the context of an absence of any known methodology for calculating what the rents would be in a "market absent an unequal bargaining position," the rent agreed to by incoming homeowners has become the only type of evidence that possibly can be produced in regards to the market rent factor.[85]

While the Delaware Supreme Court has concluded that the rents agreed to by incoming manufactured housing purchasers reflect ordinary market conditions, federal and state courts in other jurisdictions have come to virtually opposite conclusions. Instead, those courts have recognized a phenomenon that is peculiar to setting rents in manufactured housing communities (as opposed to affecting how apartment rents are set): an interplay between the rents and the prices that are paid for mobile homes.[86] As one federal appellate court explained, the "value of the rent controls is figured into the total purchase price and 'capitalized' into the value of the mobilehome ...."[87] Conversely, in the absence of rent regulation the community owner can capitalize the value of the manufactured home into the lot rent. A significant increase in the rent rather than being "absorbed" by an incoming homeowner, is absorbed by the departing homeowner in the form of a reduction in the price that the incoming homeowner is willing to pay for the home.

A Federal Circuit Court of Appeals opinion, relying on a report prepared by the community owner's expert witness, noted the magnitude of the interplay between rents and manufactured home values:

> [An] expert's report ... explain[ed] that rents for sites in their mobile home park would average about $13,000 a year without rent control, but average less than $3,300 with rent control, and that the tenants could sell their mobile homes for around an average of $14,000 without rent control, but because of rent control, the average mobile home in the park sells for roughly $120,000.[88]

While the stated purpose of the Act is to "protect the substantial investment made by manufactured homeowners,"[89] the market rent standard authorizes rent increases that enable a community owner to incorporate a portion of the value of a manufactured home into the rent.

Also, the market rent standard undermines a central protection of Delaware's Manufactured Homes and Manufactured Home Communities Act.[90] That law provides that manufactured homeowners can assign their rights under their rental agreement, including the rental amount, to the incoming purchaser of their manufactured home.[91] However, if a community owner can reset the rents for manufactured homeowners at a market level, any protection provided by the right of an incoming homeowner to assume the selling homeowner's rent level can effectively be extinguished.

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84. *Bon Ayre II*, 149 A.3d at 237 (noting that the Act "provides examples of evidence, rather than an exclusive list").

85. *See, e.g.*, Sandhill Acres HOA v. Sandhill Acres MHC, Consol. Dkt. No. 4, 2017, at 8–17 (DEMHRA July 17, 2017) (Sharp, Arb.) (arbitrator's discussion of "market rent" issues).

86. *See, e.g.*, Guggenheim v. City of Goleta, 638 F.3d 1111, 1115-16 (9th Cir. 2010); Yee v. City of Escondido, 224 Cal. App. 3d 1349 (Cal. Ct. App. 1990).

87. MHC Financing Limited Partnership v. City of San Rafael, 714 F.3d 1118, 1122 (9th Cir. 2013).

88. *Guggenheim*, 638 F.3d at 1115-16.

89. 25 Del C. § 7050 (2002) ("The continuing possibility of unreasonable space rental increases in manufactured home communities threatens to diminish the value of manufactured homeowners' investments. Through this subchapter, the General Assembly seeks to protect the substantial investment made by manufactured homeowners.").

90. *Id*. §§ 7006–22.

91. *Id*. § 7013(d)(1).

Community owners in New Jersey and California have contended that if community owners are not permitted to raise the lot rents of incoming home purchasers to market levels upon in-place sales there is an unconstitutional taking.[92] The theory underlying these claims has been that even if the laws permit rent levels which provide a fair return, upon in-place sales they allow homeowners to capture benefits of rent regulations which rightfully belong to community owners (known as the "premium" theory).[93] In a unanimous opinion in *Yee v. Escondido*, the U.S. Supreme Court rejected this type of claim, concluding that shifts in value are an ordinary outcome of regulation, rather than a "physical" taking.[94] Subsequently, when challenges based on the same premium theory relied regulatory taking claims, they were also rejected.[95]

2. A Balance in the Application of the Subsection (C) Factors

The Act requires that the proposed rent increase above a CPI increase must be "justified by 1 or more factors listed under subsection (c) of this section."[96] However, the Act does not specify whether an arbitrator may consider the factors that are not raised by the community owner and does not indicate whether factors which are not listed but relate to the purpose of the Act may also be considered.

As discussed above, when community owners have offered a market rent justification for a rent increase, arbitrators have ruled that rents may be increased up to that amount without considering what amount would be justified on the basis of the cost factors in Subsection (C).[97] The dissent in *Bon Ayre II* questioned this approach on the basis that it did not provide for consideration of the "particular circumstances" of each case in order to carry out the purposes of the statute:

> Since market rent "may" justify an increase in rent, there can be cases where it may not. While the statute provides that an arbitrator is to employ the standards set forth in § 7042, I believe that the statute gives an arbitrator the discretion to apply them with a view toward satisfying the purposes of the statute. In my view, an arbitrator can exercise discretion to deny a proposed increase to market rent if, in the particular circumstances of the case, doing so would be unreasonable or burdensome to the homeowners.[98]

However, the majority opinion did not address this interpretation of the Act.

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92. *See* Hall v. Santa Barbara, 833 F.2d 1270 (9th Cir. 1987); Pinewood v. City of Barnegat, 898 F.2d 347 (3d Cir. 1990). Both *Hall* and *Pinewood* were abrogated by *Yee v. City of Escondido*, 503 U.S. 519 (1992).

93. *See Guggenheim*, 638 F.3d at 1126; MHC Financing Ltd. Partnership v. City of San Rafael, 714 F.3d 1118, 1128 (9th Cir. 2013).

94. *Yee*, 503 U.S. at 529–30 (1992) ("Petitioners emphasize that the ordinance transfers wealth from park owners to incumbent mobile homeowners. Other forms of land use regulation, however, can also be said to transfer wealth from the one who is regulated to another.").

95. *See MHC Financing Ltd. Partnership*, 714 F.3d at 1126-29 (holding that rent control ordinance did not constitute a regulatory taking); *Guggenheim,* 638 F.3d at 1118-22 (same); Cashman v. Cotati, 415 F.3d 1027 (9th Cir. 2005) (upholding rent control ordinance and withdrawing earlier opinion finding regulatory taking based on failure "to substantially advance a legitimate government interest" after ruling in Lingle v. Chevron USA Inc., 544 U.S. 528 (2005)); Rancho de Calistoga v. City of Calistoga, 800 F.3d 1083, 1092 (9th Cir. 2015) (rejecting "private takings claim").

96. 25 Del C. § 7052(a)(2) (2002).

97. *See*, *e.g.*, Sandhill Acres HOA v. Sandhill Acres MHC, Consol. Dkt. No. 4, 2017, at 16, 20-21 (DEMHRA July 17, 2017) (Sharp, Arb.).

98. *Bon Ayre II*, 149 A.3d 227, 240 (Del. 2016) (Vaughn, J., dissenting).

The Act thus differs from the rent laws of other jurisdictions. While the Act lists factors that may be used by a community owner as justifications for a rent increase in excess of the annual allowable increase, the rent laws in other states generally list what factors "may" or "shall" be considered by the adjudicator,[99] and commonly include "fair return" and "any other relevant" factors in the list.[100] These laws provide for rent increases adequate to cover increases in operating costs, rather than triggering a right to charge "market rents."

IV. GUIDELINES FOR REFORMS CONSISTENT WITH THE PURPOSES OF THE ACT

This section provides suggestions for reforms to the Act for the purpose of providing workable standards and outcomes consistent its purposes. These suggestions include: 1) replacing the market rent factor in Subsection C with a "just, reasonable, and fair return" factor, 2) setting forth a methodology for calculating a "just, reasonable, and fair return," 3) providing more specificity about how operating expenses should be calculated for the purposes of determining allowable rent; 4) replacing the "financing" factor with a uniform interest allowance for capital improvements and operating expenses that are amortized, and 5) providing that proposed increases must be approved before they can implemented.

A. Replace the "Market Rent" Factor with a "Fair Return" Factor

As discussed, one portion of the market rent standard ("market forces absent an unequal bargaining position") rests on a measure of rent that cannot be performed. The other portion of the standard (the rent agreed to by new tenants) incorporates the peculiar imbalances in how lot rents are set in the context of manufactured housing community rentals. Provision of security of tenure and protection of the investments of manufactured housing owners depends on a system in which rent increases are tied to overall price trends and increases in operating costs. In contrast to the market rent standard in Rent Justification Act, the rent laws of other states set ceilings on rents above annual allowable increases primarily on the basis of "fair return" standards, specific cost passthroughs, and/or limited additional increases upon in-place sales.

B. Establish A Methodology for Determining "Fair Return"

While a purpose of the Act is to permit a "just, reasonable, and fair return,"[101] up to now, as far as the author is aware, none of the preceding arbitration decisions have considered what rent would meet that standard. However, the Delaware Supreme Court decisions include statements that overall returns are relevant to meeting the "directly related" requirement.[102] Given these holdings, community owners may no longer be able to obtain rent increases solely on the basis of increases in specified operating costs. Consequently, disputes about what overall returns provide a fair return may take on prominence. In turn, an absence of workable and logical fair return standards may lead to new rounds of uncertainty

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99. *See, e.g.* New York, Real Prop. Law § 233B(2) & (6) (2022) (listing factors that the court "shall take into account" in reviewing a hardship application).

100. *E.g.*, Los Angeles Cnty., Cal., Cnty. Code § 8.57.060(A)(3)(a) (2022); Escondido, Cal., Muni. Code § 29-104(g) (2021), https://library.qcode.us/lib/escondido_ca/pub/municipal_code.

101. 25 Del C. § 7050 (2022).

102. *See supra* text at notes 65-73.

and litigation.[103] Here, one type of standard – "maintenance of net operating income" (MNOI) - is strongly recommended. This standard has been repeatedly praised in appellate court opinions and is widely used in the jurisdictions that have a substantial number of manufactured housing community lots.[104] In contrast, other types of standards are fraught with conceptual and practical shortcomings.

Although the concept that the park owners are constitutionally entitled to a "fair return" is undisputed, the task of drafting a fair return standard which is legally adequate, workable and logical requires consideration of judicial precedent and overcoming some common intuitions. In 1993, a California Court of Appeal commented about the complexities of fair return issues:

> What appears at first blush to be a simple question of substantial evidence turns out to be something considerably more complex when one realizes that the formula for arriving at a "fair return" is hotly debated in economic circles and has been the subject of sparse, scattered, and sometimes conflicting comment by appellate courts.[105]

The right to a fair return is a constitutional right of owners of rental properties subject to rent regulations.[106] Consequently the courts are the final arbiters of what rent is adequate to provide a fair return.[107] While this right is a constitutional right, courts have held that the selection of a fair return standard is a legislative task, and that, at least in California, "[r]ent control agencies are not obliged by either the state or federal Constitution to fix rents by application of any particular method or formula."[108] At the same time, the courts have held that some types of standards either have no "rational basis," (a constitutional standard for the validity of legislation), or are circular in a manner that makes their use non-sensical in the context of rent regulations, and/or are fraught with other problems. In the following discussion, the alternate standards are discussed and critiqued. One standard— maintenance of net operating income ("MNOI")—has been praised by appellate courts and is now widely used under the manufactured housing community rent ordinances in California.

1. Discretionary Standards Without a Fair Return Formula

Some statutes contain lists of discretionary factors, which are often extended to include other relevant factors, to be considered in rent adjustment cases, without setting forth a specific formula or methodology for determining what

103. Numerous sources address fair return standards and jurisprudence. *See* Colony Cove v. City of Carson, 220 Cal. App. 4th 840, 869-870 (Cal. Ct. App. 2013); Kavanau v. Santa Monica Rent Control Bd., 16 Cal. 4th 761, 761-786 (Cal. 1997); Mayes v. Jackson Twp. Rent Leveling Bd., 511 A.2d 589 (N.J. 1986)); Fisher v. City of Berkeley, 37 Cal. 3d 644, 678-87 (Cal. 1984); *see generally* Kenneth Baar, *Fair Return under Mobilehome Park Space Rent Controls: Conceptual and Practical Approaches*, 29 Real Prop. L. Rep. 333 (Sept. 2006); Kenneth K. Baar, *Guidelines for Drafting Rent Control Laws: Lessons of a Decade*, 35 Rutgers L. Rev. 723, 781-817 (1983); (discussing fair return standards); Willis, *"Fair Rents" Systems*, 16 Geo. Wash. L. Rev. 104, 131, 140 (1947).

104. *See infra* text accompanying notes 133-135.

105. Palomar Mobilehome Park Ass'n v. Mobile Home Rent Review Comm'n, 16 Cal. App. 4th 481, 483 (Cal. Ct. App. 1993).

106. *See Kavanau*, 16 Cal. 4th at 771-72.

107. *See* Galland v. City of Clovis, 24 Cal. 4th. 1003, 1026 (Cal. 2001) (discussing that "fair rate of return" is a legal and constitutional, rather than an economic, term).

108. *Kavanau*, 16 Cal. 4th at 768 (citing cases).

rent provides a fair return.[109] This approach is less legislatively burdensome and provides great flexibility for adjudicators. It has proven safe from facial attack as courts have consistently rejected arguments that laws without a set formula are unconstitutionally vague.[110] On the other hand, some state supreme courts have roundly criticized such laws, even though they have not ruled that they are unconstitutionally vague.[111]

In the absence of a mandated methodology, fair return hearings become subsumed by legal and policy debates over what methodology should be used to calculate a rent providing a fair return. As adjudicators apply different methodologies, outcomes in such cases become unpredictable and varying.

2. Fair Return on Value

Under a fair return on value standard, a fair return is defined as a net operating income equal to a specified percentage of the value of the regulated property.[112] However, in a landmark case involving utility rates, the U.S. Supreme Court concluded that a return on value approach is circular in the context of price regulation.[113] The Court explained that allowable rates "cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings under whatever rates may be anticipated."[114] Consistent with this concept, California, Massachusetts, and New Jersey appellate courts have rejected claims that owners of rent-controlled properties have a constitutional right to a fair return on the "value" of their property, and have noted the circularity of return on value standards.[115]

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109. *See, e.g,* N.Y. Real Prop. Law § 233B (2022); Easton, Mass., Code § 168-5, https://ecode360.com/32675379 (2021). California ordinances initially adopted in the 1980s commonly include such standards. *See, e.g.*, Escondido, Cal., Muni. Code § 29-104; Sonoma Cnty, Cal., Muni. Code § 2-199 (2022), https://library.municode.com/ca/sonoma_county/codes/code_of_ordinances.

110. *See* Carson Mobilehome Park Owners' Ass'n v. City of Carson, 35 Cal. 3d 184, 190 (Cal. 1983); Aspen-Tarpon Springs Ltd. v. Stuart, 635 So. 2d 61, 67-68 (Fla. Dist. Ct. App. 1994). Some California municipalities preferred this approach in the 1980s due to uncertainty about what specific fair return methodologies would be struck down or mandated. *Cf.* Oceanside Mobile Home Park Owners' Ass'n v. City of Oceanside, No. N17905, at 2 (Cal. Super. Ct., San Diego C'nty, Nov. 24, 1982) (holding that the ordinance is unconstitutional because it does not provide a just and reasonable rate of return on the fair market value of the property); Cotati Alliance for Better Housing v. City of Cotati, No. 108247, at 2 (Cal. Super. Ct. Sonoma C'nty, Dec. 23, 1980) (finding maximum rent adjustment unconstitutional where adjustment is tied to return on investment rather than value). Subsequently, the California Supreme Court held that return on value standards are not constitutionally required, concluding that they are circular in the context of rent regulation. *See* Fisher v. City of Berkeley, 37 Cal. 3d 644, at 680-81 (Cal. 1984). Unpublished California trial court decisions are on file with the author.

111. *See* Mayes v. Jackson Twp. Rent Leveling Bd., 511 A.2d 589, 593 (N.J. 1986) (citing Troy Hills Village v. Township Counsil of Parsippany-Troy Hills, 350 A.2d 34, 42–43 (N.J. 1975) for the proposition that "rent control ordinances should set forth standards and criteria by which the parties, the local rent control agency, and reviewing tribunals can be guided in determining adequacy of returns actually received under the ordinance"); Yee v. Mobilehome Park Rental Review Bd., 17 Cal. App. 4th 1097, 1106 (Cal. Ct. App. 1993) (criticizing regulation that "merely lists factors to be considered by the [Mobile Home Rental Review] Board without specifying their relative impact.").

112. *E.g.*, Springfield, Mass., Mun. Code § 16-54.B (2021) ("Fair net operating income shall be that income which will yield a return, after all reasonable operating expenses, on the fair market value of the property equal to the debt service rate generally available to from institutional first mortgage lenders ….").

113. Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 601 (1944) (modifying holding in Smyth v. Ames, 169 U.S. 466, 468 (1898) that regulated utilities were entitled to a fair return on the "value" of their property).

114. *Id*.

115. *See* Helmsley v. Borough of Fort Lee, 394 A.2d 65, 71 (N.J. 1978) (noting "[o]nce income is controlled, however, using capitalization of income to determine value to regulate future income is a circular process" and providing examples of the circularity of a return on value standard); *Fisher*, 37 Cal. 3d at 680, n.33; Niles v. Boston Rent Control Adm'r, 374 N.E.2d 296, 301 (Mass. App. Ct. 1978).

3. Fair Rate of Return on Investment

Likewise, in the context of rent regulation, a fair rate of return on investment standard is circular, although it may seem intuitively reasonable. This approach allows investors to set the permissible rent by choosing their level of investment in the property, with the only cap on how much to invest being what rent the market will bear. One federal court has ruled that a lack of return on investment standard in a rent regulation cannot provide a basis for a taking claim,[116] and other courts, while not holding that this type of standard cannot be used, have noted its substantial shortcomings.[117] Apart from being circular, the rate of return on investment standard is fraught with other failings. Selecting a fair rate is a highly subjective process. Courts have only defined such a "fair" rate in vague, theoretical terms.[118] Also, they have reached widely divergent conclusions about how the investment should be calculated and about what rate of return is fair.[119] Ultimately, under a rate of return on investment standard a smorgasbord of rationale are available to support widely varying computations of the amount of the investment and of a reasonable rate.[120]

4. A Fair Ratio of Net Operating Income to Gross Income

Under a fair ratio of net operating income to gross income standard, a property owner is entitled to a rent increase if the ratio of net operating income to gross rental income is below a designated percentage.[121] The drawback of this standard is that it establishes a uniform net operating income to gross rental income ratio as fair, when, in fact, these ratios vary can widely among rental markets.[122] Owners with net operating income ratios above the fair return level cannot obtain increases to cover increases in operating costs even if those increases exceed allowable increases in rent. On

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116. *Cf.* Rent Stabilization Ass'n v. Dinkins, 805 F. Supp. 159, 163 (S.D.N.Y. 1992) (noting "such a standard would be 'unfair' because it would favor those who paid more over those who paid less for their investments," relying heavily on the more expansive reasoning about fair rate of return on investment claims in *Park Avenue Tower Associates v. City of New York*, 746 F.2d 135, 138-140 (2d Cir. 1984)).

117. *See, e.g.*, Fisher v. City of Berkeley, 37 Cal. 3d 644, 691-92 (Cal. 1984)) ("[T]he [return on investment] standard has the potential for awarding windfall returns to recent investors whose purchase prices and interest rates are high. If this latter aspect were unregulated, use of the investment standard might defeat the purpose of rent price regulation.").

118. *See* Hutton Park Gardens v. West Orange, 350 A.2d. 1, 16 (N.J. 1975) ("[T]he return should be one which is generally commensurate with returns on investments in other enterprises having comparable risks. Determination of what level of return is 'just and reasonable' involves evaluation not only of the interests of the investor but also of the interests of the consumer and of the general public sought to be advanced by the regulatory legislation."); *Kavanau*, 16 Cal. 4th at 771-772.

119. For three diverse holdings about how to calculate the investment, consider *Cotati Alliance for Better Housing v. City of Cotati*, 148 Cal. App. 3d 280, 289 (Cal. App. 1983), which held that historic investment may be adjusted by inflation in applying a return on investment standard; *Mayes v. Jackson Twp. Rent Leveling Bd.*, 511 A.2d 589, 596 n.7 (N.J. 1986), where the court noted that "increasing an investment base to adjust for inflation is not a constitutional imperative, [but] it would be an almost complete answer to a claim of confiscation"; and *Palomar Mobilehome Park Assn. v. Mobile Home Rent Review Comm.*, 16 Cal. App. 4th 481, 487-89 (Cal. App. 1993), in which the court determined that accumulated depreciation should be deducted from historic investment in order to compute investment.

120. *See* Ben Lewis, *Emphasis and Misemphasis in Regulatory Policy*, in Utility Regulation 212, 242-243 (William G. Shepherd & Thomas G. Gies eds., 1966) (noting that in disputes over a fair rate "expert contrived presentations … are turned into veritable witches' brews of statistical elaboration and manipulation").

121. *See, e.g.*, Borough of Franklin, N.J., Code § 176-23(A) (2021), https://ecode360.com/FR1843.

122. *See Mayes*, 511 A.2d at 380-381 (citing studies by author and others).

the other hand, if an owner's net operating ratio is below the minimum, the standard provides incentives to undertake excessive operating costs.[123]

5. Maintenance of Net Operating Income

The maintenance of net operating income ("MNOI") standard is based on the concept that rent increases under rent regulations should be adequate to cover increases in operating costs and provide for growth in net operating income commensurate with the percentage increase in the CPI. For example, if fair net operating income is defined as base period net operating income adjusted by 100% of the rate of increase in the CPI, where an owner's net operating income was $500,000 in the base year, and the CPI has increased by twenty percent since then, the current fair net operating income in the current year would be $600,000. The MNOI standard differs from rate of return on investment or return on value standards because it is based on a comparison of the base year and current year net operating income, rather than only considering the return in the current year.[124]

Notably, in calculating net operating income, debt service is not considered as an operating cost.[125] Thus, all owners have a right to an equal rate of growth in NOI regardless of differences in their length of ownership and investment and financing arrangements. Under the MNOI standard, an investor must determine what investment and financing arrangements will make sense if the rate of growth in net operating income may be limited to the rate of increase in the CPI.

By providing a right to charge rents that will provide for growth in net operating income, the MNOI standard allows growth in the return that is available to pay for increases in debt service, to fund capital improvements, and/or to provide additional return on cash investment. Growth in net operating income also provides for appreciation in the value of a property.[126] This approach meets the twin objectives of protecting tenants from excessive rent increases that are not justified by operating cost increases and increases in the CPI, and of providing regulated owners with an increasing return on their investment.[127] As one California Court of Appeal has noted, MNOI provides the "best available option" for regulating rent levels.[128]

123. For example, in order to maintain a net operating income ratio of 50%, for each $100,000 in additional operating expenses, an additional $200,000 in gross income is required.

124. While the courts have held that no particular type of fair return standard is constitutionally required, also they have held that not permitting growth in net operating income is confiscatory. Helmsley v. Borough of Fort Lee, 394 A.2d 65, 76 (N.J. 1978); Fisher v. City of Berkeley, 37 Cal. 3d 644, 683 (Cal. 1984). The MNOI standard is the only type of standard which considers this factor.

125. *See, e.g.* San Jose, Cal., Muni. Code § 17.22.540(B)(1) (2022). Typically, the exclusions set forth an exception for cases in which refinancing is compelled by the terms of a mortgage entered into prior to the adoption of the rent regulation will result in higher interest costs. *See e.g.* Fremont, Cal., Muni. Code § 9.55.160(c)(11)(A) (2021), https://www.codepublishing.com/CA/Fremont/ (excluding mortgage interest except for increases in mortgage costs when associated with refinancing compelled by the terms of mortgage entered into prior to December 1, 1985).

126. In contrast, under rate of return on investment standards, owners who have been obtaining more than the minimum rate may not be able to obtain a rent increase to cover cost increases and provide for growth in net operating income above pre-regulation levels or levels of prior years if rate of return remains above the specified minimum. This outcome would be common for long term owners who have low investments relative to their current income.

127. *See* Rainbow Disposal v. Mobilehome Park Rental Review Bd., 64 Cal. App. 4th 1159, 1172 (Cal. Ct. App. 1998) ("MNOI approach … is a fairly constructed formula' which provided [the park owner] a sufficiently 'just and reasonable' return on its investment"); *see also* Colony Cove v. City of Carson, 220 Cal. App. 4th 840, 869-870 (Cal. Ct. App. 2013) (noting that the MNOI standard "permits park owners to obtain a just and reasonable return under general marketing conditions in any given year" and "reflect[s] the tenant's interest by giving the park owner an incentive to incur all reasonable expenses for maintenance and services." (quoting Oceanside Mobilehome Park Owners' Ass'n v. City of Oceanside, 157 Cal. App. 3d 887, 902–03 (Cal. Ct. App. 1984))).

128. *Colony Cove*, 220 Cal. App. 4th at 869 (quoting H.N. & Frances C. Berger Found. v. City of Escondido, 127 Cal. App. 4th 1, 9 (Cal. Ct. App. 2005)).

Under MNOI standards a year preceding the adoption of the rent regulation is usually specified as the base year, on the basis that the net operating income prior to the adoption of rent regulation reflected market conditions.[129] However, since Delaware has had rent regulations for eight years, an option of allowing owners to use a designated base year shortly preceding the adoption of an MNOI standard may be appropriate because some owners may not have income and expense records from 2013.[130] Since the Act has authorized full CPI increases since 2013, a reasonable, rebuttable presumption would be that the pre-rent regulation rent levels adjusted by the full increase in the CPI in the years prior to the designated base year provide a fair profit level.

For owners who charged very low rents in the base year, inflation adjusted levels of base year net operating income will remain low. In order to place owners with very low base year rents on equal footing under the MNOI standard, California courts have ruled that the base year rents which do not reflect market conditions must be adjusted upward to establish base year net operating income when calculating a fair net operating in the current year.[131] The MNOI standards in California generally have a provision that allows for adjustment where base year rents are "disproportionately" low. [132]

Currently, the MNOI standard is widely used in local California manufactured housing rent regulations.[133] California appellate courts have upheld the MNOI methodology, and repeatedly praised it as the most reasonable fair return standard.[134] The New Jersey Supreme Court has similarly commented favorably on its use.[135] Including this methodology in Delaware's Rent Justification Act or in regulations adopted pursuant to the Act would be similarly following best practice.

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129. *See, e.g.*, Santa Cruz Cnty., Cal., Cnty. Code § 13.32.040(B)(4) (2021).

130. The adoption of an MNOI standard could include notice that base year income and expense information would be required in fair return petitions. Commonly under the MNOI standards in California ordinances, if base year operating expense information is not available, the expense amounts for the base year may be estimated based on available information or rebuttable presumptions about the rates of increase in different types of expenses. See San Jose, Cal., Muni. Code § 17.22.495; City of Yucaipa, Cal., Admin. Rules § 4.0003(F) (2022) ("Where scheduling of rental increases … require projections of income and expenses because actual data is not available, it shall be presumed that operating expenses and management expenses … increase at the rate of the increase in the CPI for the applicable year ….").

131. Vega v. City of West Hollywood, 223 Cal. App. 3d 134 (Cal. Ct. App. 1990) (allowing upward adjustment to base year rent where elderly apartment building owner had not raised the rents in 20 years preceding the base year, which, without adjustment, would have resulted in exceptionally low fair net operating income in the current year even when adjusted for inflation.); *see also* Concord Communities v. City of Concord, 91 Cal. App. 4th 1407, 1417-18 (Cal. Ct. App. 2001) (applying principles in *Vega*); Apartment Ass'n of Greater Los Angeles v. Santa Monica Rent Control Bd., 24 Cal. App. 4th 1730, 1737 (Cal. Ct. App. 1994) (finding "regulation which prohibits landlords who purchased rental property after the inception of rent control from seeking an adjustment to base rent" facially invalid, while recognizing there is "no general entitlement to an increase in base date rents predicated on market conditions").

132. *See, e.g.*, San Jose, Cal., Muni. Code §17.22.510 (2022) (providing other grounds for adjusting base year net operating income include extraordinarily low income and/or expenses in the base year).

133. *See, e.g.*, Riverside Cnty., Cal., Cnty. Code §§ 5.36.090(B), 5.36.250 (2022), https://library.municode.com/ca/riverside_county/codes/code_of_ordinances; San Jose, Cal., Muni. Code § 17.22.550 (2022).

134. *See Colony Cove*, 220 Cal. App. 4th at 869-870, 844-845 ("By maintaining net operating income, adjusted upward for inflation, from year to year, this approach allows for appreciation and permits the purchaser to determine whether the property is worth the selling price based on the purchaser's individual cash flow requirements and its future plans for the property."); *Rainbow Disposal*, 64 Cal. App. 4th 1159, 1172 (Cal. Ct. App. 1998); Palomar Mobilehome Park Ass'n v. Mobile Home Rent Review Comm'n., 16 Cal. App. 4th 481, 486 (Cal. Ct. App. 1993); Baker v. City of Santa Monica, 181 Cal. App. 3d 972, 975–76 (Cal. Ct. App. 1986); Oceanside Mobilehome Park Owners' Ass'n v. City of Oceanside, 157 Cal. App. 3d 887 (Cal. Ct. App. 1984).

135. *Mayes*, 511 A.2d. at 589.

C. Establish Reasonable Criteria for the Treatment of Expenses

Questions about the proper treatment of expenses for the purpose of calculating an allowable rent have emerged in arbitration cases and will continue to surface. They are likely to take on a more important role if community owners are required to demonstrate that overall expenses have increased or that net operating income has decreased in order to meet the "directly related" standard and/or community owners cannot rely on a market rent standard. Up to now, differences among arbitrators and courts about how to treat expenses have led to enormously disparate outcomes.[136] It is not possible to draft guidelines that will anticipate and resolve every type of situation that will emerge. However, more detailed amendments to the law or regulations could resolve some of the issues that have recurred in arbitrations pursuant to the Act or have emerged in other states and are likely to emerge in future cases in Delaware.[137]

1. Allowances for Capital Improvements and Other Expenses Which Are Not Annually Recurring

Under the existing Act, arbitrators have struggled to differentiate between capital improvements and operating expenses, and have acknowledged the difficulties of coming up with a precise or universally accepted definition.[138] For example, disputes have emerged over whether major system replacements that are not superior to the former system are capital improvements.[139] Other issues arise concerning rent increase allowances for operating expenses which are exceptional, rather than recurring, such as remediation of accidents, storm damage, or other disasters, major landscape overhauls, exceptional legal expenses, or one-time assessments.

The issue under a rent justification act should not be whether the cost can be classified as a capital improvement, but whether it is non-recurring and what methodology will provide a reasonable allowance for the cost.[140] If the cost is

136. *See* December Corp. v. Wild Meadows Home Owners Ass'n, 2016 WL 3866272, at *7 (Del. Super. July 12, 2016) (holding that an increase in the base rent is permanent even though "one time capital improvement charges are long since recovered"), *abrogated* by Rehoboth Bay Homeowners' Ass'n v. Hometown Rehoboth Bay, 252 A.3d 434 (Del. May 13, 2021). In *December Corp.* the Superior Court acknowledged the problematic nature of this outcome, but concluded that it was bound by the "clear language of the statute" to authorize a permanent increase because the Act did not include a "one time cost recovery rider." *Id*. A few years later, two arbitration decisions were upheld in Superior Court on the basis of *December Corp*. awarded permanent rent increases of approximately $75 per month per lot for costs that would be recovered in one year. Iacona v. Hometown Rehoboth Bay, LLC, 2020 WL 4559459 (Del. Super. Aug. 6, 2020); Rehoboth Bay Homeowners' Ass'n v. Hometown Rehoboth Bay, 2021 WL 1316831 (Del. Super. March 16, 2020). When the Delaware Supreme Court heard those cases in a consolidated appeal, it took a different view, holding:

> Once the cost of a non-recurring capital improvement is recovered by the community owner in full through a rent increase, the continued assessment of that increase indefinitely becomes unrelated to the benefits and costs of living in the community. Under the Superior Court's interpretation of § 7052 in *December Corp*. unreasonable and burdensome rent increases [were] inevitable.

Rehoboth Bay Homeowners' Ass'n, 252 A.3d at 444. Notably, it took five years to overturn a rent adjustment methodology which was clearly inequitable and diametrically counter to the purposes of the Act.

137. For detailed guidelines regarding the treatment of expenses in manufactured housing community rent arbitration cases, *see* Humboldt Cnty., Cal., Cnty. Code § 9101-10 (2021).

138. *See* Iacona & Weymouth v. Hometown Rehoboth Bay, LLC, Dkts. 7 & 8, 2016, at 5-6 (DEHMRA March 6, 2017) (Young,Arb.); Sunset of Affected Lots in Holly Hill Estates v. Holly Hill Estates, Dkt. No. 6, 6 (DEHMRA Aug. 10, 2017) (Morton, Arb.).

139. *Iacona & Weymouth,* Dkts. 7 & 8, 2016, at 5-6.

140. *See, e.g.*, Vt. Stat. tit. 10, § 6251(b) (2022) (limiting a lot rent surcharge for the cost of capital improvements to the period "when the park owner has recovered the cost of the capital improvements").

substantial and occurs only infrequently or is only one time, it should be amortized, with an interest allowance added into the cost.[141] As a matter of constitutional law, when the cost of a capital improvement is amortized for the purposes of determining an allowable rent increase in order to compute the fair measure of the cost, an interest allowance is required.[142] The interest allowance should be uniform in all cases, at a rate reflecting typical loans for purchases of income producing rental properties, rather than varying by the particular community owner. Otherwise, different owners would be entitled to vastly differing rent adjustments for comparable expenditures, depending on how they finance the cost and, by extension, the particular circumstances of the owner and the park.

Another issue is whether capital improvements which are replacements or upgrades of existing systems should be authorized as separate stand-alone passthroughs or should be considered in the context of what rent increases are required to provide a fair return, taking into account the overall income and operating expenses and income history of a community. If overall returns and increases in rents are not considered, communities with increases in income that have been well in excess of the CPI increase will be provided with the same increases for capital improvements regardless of whether their growth in net operating income has been adequate to cover these costs. Capital improvements which are replacements are normal in the ownership of rental properties and expected to be anticipated in setting the acquisition price for such properties.

2. Reasonability of Expenses

Subsection (C) provides that "changes in *reasonable* operating and maintenance expenses" may be a justification for a rent increase above the CPI increase, without any elaboration of the term "reasonable."[143] This standard opens up a broad range of considerations for potential review, including whether the particular expenses are typical compared to other years, and/or in keeping with normal expense levels in the industry. Under the rent laws in other states, community owners are commonly required to submit several years of data so it can be determined whether particular types of operating expenses or expense levels are ongoing or are atypical and should be adjusted or amortized.[144] Also, some laws

141. In some instances, arbitrators have concluded that community owners may be entitled to rent increases to cover the costs of capital improvements which are uncompleted. *E.g.*, Ruben v. Bon Ayre Land LLC, Dkt. No. 17-598, at 3 (DEHMRA Sept. 22, 2017) (Kuhl,Arb.) (requiring completion "could prevent an owner from initiating any desired improvements if rent adjustments could not take place until the improvement is completed."). It does not seem reasonable to require owners to pay for improvements before they start receiving the benefits of the improvements, just as it would not be reasonable to require homeowners to pay space rents for periods prior to the date when they could possibly occupy the community because its construction had not been completed. On the other hand, community owners should be provided with a right to find out in advance of a planned substantial expenditure what rent increase would be allowed if it is undertaken. One approach is to provide for a right to obtain an advance determination of the amount of a rent increase that would be granted when the proposed capital improvement is completed, thereby providing certainty and an ability to realize a recovery as soon as the improvement is completed. Some regulations "[i]n order to promote advance fiscal planning" provide "park owners … the option of precertifying capital improvements … in advance of performing the work" to determine if the costs can be passed on to the effected residents pro rata. Fremont, Cal., Muni. Code § 9.55.07(a) (2021).

142. Sierra Lake Reserve v City of Rocklin, 938 F.2d 951, 958 (9th Cir. 1991) ("To the extent plaintiff alleges that the rent increases allowed on account of capital improvements merely offset the cost of those improvements (or less), it has stated a claim for a violation of substantive due process."); *see* Morgan v. City of Chino, 115 Cal. App. 4th 1192, 1199-1200 (Cal. Ct. App. 2004) (citing cases and holding that an owner does not have a right to an increase for a capital improvement cost independent of consideration of overall income and expenses in order to determine what increase is necessary in order to permit a fair return).

143. 25 Del C. § 7052(c)(5) (2022) (emphasis added). The Delaware Supreme Court has indicated that the statutory requirements in order to justify a rent increase are "modest." *Bon Ayre II,* 149 A.3d 227, 235 (Del. 2016). When considering what requirements may be "modest" relative to the stakes in a rent adjudication, one perspective is that a $25/space/month rent increase in a community with 100 spaces will add $30,000/year to annual rental income and about $500,000 to the market value of the community.

144. *See, e.g.*, 31 R.I. Gen. Laws § 31-44.1-2(c) (2022); Humboldt Cnty., Cal., Cnty. Code, § 9101-11(c)(3)(D) (2021); Belchertown, Mass., Muni. Code § 235-9.(A)(1) (2021), https://ecode360.com/BE1703 (three years of income and operating expense data required).

specifically provide that industry norms shall be taken into consideration.[145] Consideration of these factors is essential to insuring reasonable outcomes.

3. Treatment of Debt Service

The Subsection (C) factors include "changes in … financing associated with the manufactured home community."[146] Up to now, debt service has not been considered as a factor in the arbitration decisions, unless it was associated with the financing of capital improvements.[147] However, in future cases, new purchasers may raise claims based on their mortgage financing.

When determining allowable rents, financing costs should be seen as a cost of capital used to purchase a manufactured housing community or, in the case of refinancing, as a source of funds using a community as collateral. Otherwise, if community owners can charge their tenants for their purchase mortgage interest payments, then the homeowners are bound to fund the community owner's investment in the land, as well as providing a fair net operating income that will cover the mortgage payments associated with the investment.[148]

While repeatedly holding that the formulation of a fair return standard is a legislative task,[149] appellate courts in Massachusetts, New Jersey, and California have concluded that it is not appropriate to take into account debt service when determining allowable rents under rent regulation.[150] The reasonable approach is to exclude debt service for purchase

145. *E.g.*, El Monte, Cal., Muni. Code § 8.70.080(E)(3)(c)(iv) & (v) (2021), https://library.municode.com/ca/el_monte/codes/code_of_ordinances (expenses exceeding the normal industry standard must be shown to be reasonable, and base year expenses which are exceptionally low by industry standards may be adjusted upwards).

146. 25 Del C. § 7052 (c)(4).

147. *See, e.g.*, Wild Meadows Homeowners Ass'n v. Wild Meadows MHC, LLC, Dkt. No. 10-2017, at 17 (DEMHRA, Jan. 21, 2019) (Gibbs, Arb.) (finding that "acquisition costs and debt service, which relate to the community owner's underlying investment in the community itself" cannot be tied to how return is computed for purposes of meeting the directly related requirement).

148. Under standard mortgage lending criteria net operating income must be adequate to cover mortgage debt service. *See* Mike E. Miles et al., Real Estate Development 219 (2015) ("[L]enders generally require a DSCR [Debt Service Coverage Ratio] between 1.20 and 1.60.").

149. *See supra* note 108 and accompanying text.

150. *See* Zussman v. Rent Control Bd. of Brookline, 359 N.E.2d 29, 34 (Mass. 1976) (holding that "a landlord's decision to minimize or wholly eliminate his initial capital outlay cannot justify imposing higher rents on his tenants. Nor does it warrant permitting him to collect higher rents than other less heavily financed landlords."); Helmsley v. Borough of Fort Lee, 394 A.2d 65, 80-81 (N.J. 1978) ("Discrimination based upon the age of mortgages serves no legitimate governmental purpose."); Palomar Mobile Home Park Ass'n v. Mobile Home Rent Review Comm'n, 16 Cal. App. 4th 481, 488 (Cal. Ct. App. 1993) ("Palomar's version of the 'historic cost' formula means that an owner's fair return will vary depending on the financing arrangements…. We see no reason why this should be the case."); Colony Cove Properties, LLC v. City of Carson, 220 Cal. App. 4th 840, 870-871 (Cal. Ct. App. 2013) ("Apart from the inequities that would result from permitting a party who financed its purchase of rent-controlled property to obtain higher rents than a party who paid all cash, there are additional reasons for disregarding debt service…. [D]ebt service arrangements could easily be manipulated."). *But see* Palacio de Anza v. Palm Springs Rent Review Comm'n, 209 Cal. App. 3d 116, 120 (Cal. Ct. App. 1989) (holding that community owners have a vested right to have their debt service considered if debt service was listed as an expense for the purpose of calculating net operating income when the property was purchased); El Dorado Palm Springs, Ltd. v. Rent Review Comm'n, 230 Cal. App. 3d 335, 343 (Cal. Ct. App. 1991) (holding same). The Palm Springs ordinance, however, was distinguishable from the Delaware statute and most other California ordinances because at the time it specifically included mortgage payments as an allowable expense in the calculation of net operating income.

financing in setting allowable rents, while at the same time providing for a uniform interest allowance for the recovery of operating costs and capital improvements which are amortized.[151]

D. The Effective Date of Proposed Rent Increases

Currently, manufactured homeowners must begin paying rent increases in excess of the CPI increase as soon as they are proposed, rather than waiting for a determination as to their validity in arbitration.[152] Under California ordinances proposed increases cannot be implemented until they are approved or unopposed.[153] If substantial rent increases can be imposed prior to a determination of whether they are permissible, homeowners may be pressured into reaching settlements because they cannot afford an increased rent level, even though the increase may not have been justified under the Act. To avoid unnecessary hardship on the lessees while also making landlords whole, the California Supreme Court ruled that allowable rent increases include a right to retroactive rent charges to cover the period when the rent increase should have been permitted.[154]

V. CONCLUSION

The Rent Justification Act remains mired in uncertainty concerning the conditions for obtaining rent increases and the standards for setting allowable increases. Outcomes vary wildly at the arbitration, Superior Court, and Supreme Court levels. The following amendments to the Act are critical to its operation in a consistent, predictable, and workable manner that will fulfill its purposes:

1. Clarifying what evidence is required to meet the "directly related" standard;
2. Linking the amounts of allowable rent increases above the CPI increase to the amount of specific expense increases, an increase in overall expenses, and/or to the amount necessary to provide a fair return;
3. Requiring that all of the factors in Subsection C be taken into account in determining what rent increase is allowable, in order to provide outcomes consistent with the overall purposes of the Act;
4. Replacing the "market rent" standard in the Subsection C factors with a "just, reasonable, and fair return" factor; and
5. Setting forth a specific methodology for calculating a "just, reasonable, and fair return."

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151. *See, e.g.*, El Monte, Cal., Muni. Code §8.70.080(E)(3)(a)(ix) (2021) (providing that the interest allowance for expenses that are amortized are tied to a particular published average interest rate on single family mortgages plus two percent).

152. 25 Del. C. § 7053(l) (2022).

153. *See, e.g.*, San Bernardino, Cal., Muni. Code § 8.90.290 (2022), https://sbcity.org/residents/municipal_code.asp; San Jose, Cal., Muni. Code § 17.22.617(E) (2022); *but see, e.g.*, Vt. Stat. tit. 10, § 6253(b) & (e) (2022) (requiring proposed rent increases to be paid into the court pending resolution).

154. *Kavanau v. Santa Monica Rent Board*, 16 Cal. 4th 766, 783-784 (1997). In *Kavanau*, the full rent increase was denied at the initial adjudicatory level, but was granted pursuant to an appeal, after a substantial lapse of time. *Id*. at 767. In cases where the adjustment is large, some rent boards have provided for the recovery on an amortized basis with an interest allowance from the date of the original adjudication through the end of the amortized recovery period. *See, e.g.*, Yucaipa Rent Review Commission, Resolution No. 2008-29 ¶ 29 (June 26, 2008) (on file with author). This type of rent adjustment is now known as a "Kavanau adjustment." Galland v. City of Clovis, 24 Cal. 4th 1003, 1008 (2001).

A fair and workable balance between community owners and homeowners depends on a predictable system that allows community owners to obtain a fair return while protecting manufactured homeowners from rent increases that are not justified by increases in their costs of operating communities and inflation.

ADDENDUM

This addendum briefly describes and comments on critical aspects of the amendments to the Act which went into effect on July 1, 2022.[155]

Starting out the gate, it should be noted that the amended law is extremely difficult to decipher. New sections which are now in effect but sunset in five years and other new sections which do not sunset are interspersed among sections that are now suspended for five years. The amendments are heavily populated with cross-references, which must be navigated in order to comprehend them. The outcome is a maze, rather than a readily comprehensible Act.[156]

In substantive terms, the 2022 amendments include a 3.5% floor on the annual increases authorized pursuant to the CPI standard.[157] The amendments provide that operating cost information used to justify rent increase claims is public record.[158] Also, the amendments rectify some of the previous uncertainties in the law. For five years, the law suspends the requirement that community owners demonstrate that their proposed increases in excess of CPI meet the vague "directly related" standard, which led to rounds of dispute and litigation at the arbitration, superior court and supreme court level.[159] The amendments also include a specific formula for calculating the amount of allowable rent increases above CPI if they are justified by operating cost increases.[160] In contrast, the suspended portions of the Act listed types of relevant expenses but did not provide any direction in regards to how the increases in their costs should be weighed.[161]

On the other hand, other amendments undercut the purposes of the Act. The amendments embed as a standard the rents agreed to by incoming mobile home purchasers as an allowable rent for all the manufactured homeowners in a community. Another amendment, which is in effect for five years, provides that leases that are more than one year are exempt from any rent regulation.

A. "Market Rent" Embedded as a Stand-Alone Measure of Allowable Rent

Under the earlier act, "market rent" was one of a list of factors that "may" justify a rent increase above the CPI increase.[162] Under the amended Act, which is in effect for five years, community owners may increase rent based on the

155. 83 Del. Laws 341 § 11 (June 30, 2022).

156 . *Id*. §§ 3, 4; *see also infra* text accompanying note 182 (describing the complexities of the rental assistance standard).

157. *Id*. § 4 (adding 25 Del. C. § 7052A(c)(2)(a)). Note that it is unclear whether the rate of increase may fall below 3.5% if the CPI falls below zero.

158. *Id.* (adding 25 Del. C. § 7052B(a)(1)).

159. *See id*. § 3 (amending 25 Del. C. § 7052(a)); *see also supra* text accompanying notes 46–75.

160. *Id*. § 4 (adding 25 Del. C. § 7052B). Under the formula, the allowable increase is equal to the amount by which the aggregate of increases in specified operating expenses (taxes, insurance, utility charges, employment benefits and employment taxes) has exceeded the percentage increase in the CPI. *Id*.

161. *See* 25 Del. C. § 7052(d) (2022).

162. 25 Del. C. § 7052(c)(7) (2022).

"market rent" standard without having to meet the "directly related" standard.[163] The amended law effectively establishes a stand-alone right to such increases, subject only to the qualification of compliance with health and safety standards, assuming the tenant does not qualify for the "rental assistance" provisions.[164]

Notably, the amendments include other provisions that moderate the impact of the "market rent" standard. They provide that increases justified by this benchmark must be phased in over seven years, if they are not more than fifty percent of the current rent, and over a ten year period, if they are a higher percentage of the current rent.[165] Also, they provide that CPI rent adjustments cannot be imposed in the same year as market rent adjustments.[166] If inflation rates are high the rent increases authorized under the market standard may not be much above the amounts authorized under the CPI standard, or may even be lower. Conversely, they may be substantially higher than CPI-based standards during periods of low inflation. The "rental assistance" provisions for qualifying low- and moderate-income households are another moderating factor that may or may not have a substantial impact.[167]

Among the manufactured housing community rent legislation in the United States, Delaware remains apart in providing that the rents agreed to by new tenants in a community and comparable communities are the measure of allowable rents for all the tenants in the community, rather than only new tenants who have agreed to the new market rent levels. Apart from the conceptual issues associated with the "market rent" standard,[168] on a practical level the standard will generate unequal contests in disputes about the actual level of market rents and games of manipulation.[169]

The bottom line is that the "market rent" standard turns tenancy in manufactured housing communities and investments in purchasing manufactured homes into a speculative and risky venture by vitiating certainty that rent increases will be proportionate to increases in the CPI or, if above the CPI, limited to the amounts that may be justified by increases in the community owners operating costs and costs of capital improvements.

B. The Lease Exemption

Under the amendments to the Act, rental agreements that are entered into within the next five years which are over a year in duration are exempt from its rent increase regulations.[170] California adopted this type of exemption in 1985, but then modified its law in 2020 to withdraw the exemption from rental agreements entered into after February of that

163. *See* 83 Del. Laws 341 § 4 (adding 25 Del. C. § 7052A(b)(1)(b)).

164. *See id.* §§ 4, 7.

165. *See id.* (adding 25 Del. C. § 7052A(d)(3)).

166. *See id.* (adding 25 Del. C.§ 7052A(b)(1)).

167. See *infra* at text accompanying notes 176–181.

168. See *supra* at text accompanying notes 76–95.

169. Potential manipulations in the rent setting process for incoming homeowners include offering community owned homes at low prices in order to obtain agreements to higher initial rents or setting initial rents at a higher level in return for lower increases in future years. On a practical level an arbitration over the level of the market rent level pits community owners who can easily find appraisers who specialize in manufactured housing community transactions against homeowners who have to find an appraiser who both has knowledge about manufactured community space rents and is willing to testify against the interests of their primary economic source, the real estate industry. In California, in cases which rent data from comparable manufactured housing communities is considered in order to determine whether the average rent in a community was disproportionately low in either a base year or the current year, cities commonly employ another appraiser to provide an independent review of the appraisal submitted by the community owner.

170. *See* 83 Del. Laws 341 § 1 (adding 25 Del. C. §§ 7052A(b)(1)(c).

year.[171] Before withdrawing the exemption altogether, the state adopted several laws in attempts to curb its abuses, such as requiring that community owners notify homeowners of their right to have thirty days to inspect the agreement, providing a right of recission within 72 hours of signing an exempt agreement, and requiring a notice that homeowners must be offered a rent controlled lease on the same essential terms.[172]

In opposition to claims that the lease exemption was detrimental to the interests of homeowners, California community owner representatives maintained that homeowners only enter into such agreements because they perceive some benefit that outweighs the benefits of rent control.[173] However, homeowner representatives explained that:

> [T]he protections in existing law do little to overcome the fundamental asymmetry at the heart of this bargaining relationship. In contrast to most mobilehome residents, park owners are constant and repeat players in mobilehome lease negotiations, they are versed in mobilehome law, and they often have ready access to sophisticated legal counsel.[174]

One city council letter explained that the exemption was completely undermining the rent regulations:

> [T]he state law exempting long-term leases has allowed for abuses that render ineffective the City's mobile home rent stabilization program… Not surprisingly, most residents of mobilehome parks do not have the resources to sue Park owners that have inappropriately maneuvered them into long-term leases… The long-term lease exemption is serving to completely undermine the City's rent stabilization regulations and damage the affordability of its housing stock.[175]

C. The "Rental Assistance" Provisions

Under the amendments, the existing Lot Rental Assistance program, which places limits on allowable rents based on household income, has been modified in part and expanded in part. These restrictions are categorized as "rental assistance," but they refer to restrictions on the allowable rent, rather than public assistance.[176] Eligibility for the assistance is limited to homeowners who, among other things, have resided in a community for five or more years and have liquid assets under $50,000.[177] These rights cannot be transferred to new owners.[178]

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171. Cal. Civ. Code § 798.17(i)-(j) (2021).

172. Senate Judiciary Bill Analysis, SB-999, 2019-2020 Reg. Sess. at 3 (Cal. 2020), *available at* https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201920200SB999 (providing history of earlier efforts to amend Section 798.17 and setting forth the rationale for and against withdrawing the exemption.).

173. *See id.*

174. *Id*.

175. Letter from Carpinteria City Council Members to Sen. Tom Umberg, Cal. Senate (Feb. 24, 2020) (on file with author).

176. *See* 83 Del. Laws 341 § 7 (amending 25 Del. C. § 7022).

177. *See id*. (amending 25 Del. C. § 7022(a)). Previously, the existing program placed a limit on eligibility for homeowners who owned their homes as of a date certain, July 1, 2006, rather than a set period of time. See 75 Del. Laws 382 § 7 (2006).

178. *See* 83 Del. Laws 341 § 7 (amending 25 Del. C. § 7022(a) and adding § 7022B(c)).

The existing "rental assistance," with its updated eligibility requirements, includes a ceiling on lot rents of thirty percent of the income of homeowners with a household income below forty percent of the median.[179] This ceiling might seem to parallel the standard limit which is generally applicable in subsidized housing, where rents plus utility costs are typically limited to thirty to thirty-five percent of income.[180] However, unlike apartment owners, manufactured housing community owners do not provide housing structures. Instead, the costs of acquiring and maintaining the dwelling are an additional cost above the lot rent, rather than a cost included in the thirty percent ceiling. Also, utilities are usually an additional cost above the lot rent. Thus, the thirty percent cap on the lot rent to income ratio only takes into account one portion of the housing costs, leaving out central components of the real cost.

The new addition to the Lot Rental Assistance program in the amendments introduces a unique type of standard which is applicable to households which have an income ranging from forty to fifty-five percent of the county median. The law contains a sliding scale of the percentage of allowable rent increases that may be imposed on tenants in this income range, as opposed to a ceiling on the rent to income ratio.[181]

Apart from being unique in concept, the standard is incredibly complex. The percentage reduction below the otherwise allowable rent increase depends on the ratio of the household income to the published median household income in the particular year. The amounts of the reductions are based on a formula in which household income/median income ratio categories are divided into seven two-percent increments and accompanied by seven differing ratios of the portion of otherwise allowable rent increases that may be imposed.[182] Consequently, within a community there may be eight different answers about the allowable percentage rent increase in any particular year: seven for the "assisted" homeowners within an income ranging from forty to fifty-five percent of the median, and another for the "unassisted" homeowners.

Outside of Delaware the underlying paradigm of rent regulation has been to limit rent increases to reasonable levels, rather than to tie allowable increases to individual household income levels. Apart from this observation, consideration from a legal and practical perspective of how these "rental assistance" provisions will turn out is beyond the scope of this addendum.

D. Informing the Public and Lawmakers About the Outcomes Under the New Law

The Act requires that copies of notices of all rent increases must be provided to DEMHRA.[183] It would be invaluable to require that the notices include additional information, including (a) the standard under which each rent was set (e.g. CPI, market rent, exempt lease, increases subject to limitations set by the rental assistance provisions) and (b) the types of utility costs that are passed through, apart from the lot rent, and the amounts of those passthroughs. This information should be collected in a database used to prepare public reports on overall rent levels, the amounts of rent increases,

179. *See id*. (amending 25 Del. C. §7022(d)).

180. *See, e.g., Services for Renters*, Delaware State Housing Authority, http://www.destatehousing.com/Renters/rt_s8hcv.php (last visited August 3, 2022) (noting cap on rent and utility payments of thirty to thirty-five percent of income in Section 8 housing program).

181. *See id*. (adding 25 Del. C. § 7022B(d)).

182. *Id.* (allowing rent increase of *e.g.* 24.25% if "the median household income is greater than 40% and below 42%", or 38.5% if "median household income is equal to or greater than 42% and below 44%….").

183. *See id.* § 2 (amending 25 Del. C. § 7051(c)(1)).

the bases for the increases, and the outcomes under the "rental assistance" requirements.[184] This step would provide the public and lawmakers with substantial information (as opposed to anecdotes) about how a law that determines the rents of 20,000 households is actually working and on the actual impacts of each of the rent increase mechanisms in the law.

E. Summary

The purpose of manufactured housing community rent regulations is to protect the security and investments of manufactured homeowners. Tying allowable rent increases to increases in the CPI, with greater increases permitted when needed in order to obtain a "fair return" or cover operating cost increases is a reasonable and standard approach for accomplishing this objective. Instead, under the revised Act, the rents agreed to by incoming tenants in a subject community and comparable communities are a determinant of allowable rents for the other homeowners in a community, and rent levels set in leases of one year or more are exempt from regulation. These avenues incorporate, rather than correct, the imbalances in market conditions that spur the adoption of regulations of rent increases in manufactured housing communities.

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184 . Publicly available data and reports could be limited to aggregate data when necessary to protect confidential information about individual homeowners.