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IN THE SUPREME COURT OF THE STATE OF DELAWARE

SANDHILL ACRES MHC, LC,	)	No. 525, 2018
	)	
Respondent Below, Appellant,	)	
	)	
v.	)	
	)	UPON APPEAL FROM THE
SANDHILL ACRES HOME OWNERS	)	SUPERIOR COURT OF THE
ASSOCIATION	)	STATE OF DELAWARE IN
	)	C.A. NO. S17A-08-001 ESB
Petitioners Below, Appellee.	)	

APPELLANT'S OPENING BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

NATURE OF PROCEEDINGS 1

SUMMARY OF ARGUMENT 3

STATEMENT OF FACTS 6

A. THE PARTIES 6

B. BACKGROUND 6

1. Implementation of Rent Justification Act 7

2. How a Rent Increase Must be Disclosed, Justified and Implemented 8

C. THE ARBITRATOR CORRECTLY FOUND THAT SANDHILL COMPLIED WITH THE RENT JUSTIFICATION ACT 12

1. Sandhill's Market Rent is Justified under 25 Del. C. § 7042(c)(7). 12

a. Sandhill Accepts the CPI-U Rate for a Portion of its Rent Increase 12

b. Sandhill Proves its Market Rent is $455 per Month. 13

c. Sandhill Incurred An Expense That Affected Its Expected Return as Required by *Bon Ayre II* 15

d. Sandhill Gives Appropriate Notice of its Rent Increase 17

e. Sandhill, In Good Faith, Disclosed the Basis of its Rent Increase to the Market Rate of $455 18

D. THE ARBITRATION PROCEEDINGS 19

ARGUMENT 21

I. THE SUPERIOR COURT ERRED AS A MATTER OF LAW WHEN IT DISALLOWED ALL OF SANDHILL'S RENT INCREASE EVEN THOUGH SAHOA WAS NOT CHALLENGING TWO PORTIONS OF THE RENT INCREASE 21

A. Question Presented 21

B. Scope of Review……………………………………………21

C. Merits of Argument…………………………………….......21

II. THE SUPERIOR COURT ERRED AS A MATTER OF LAW WHEN IT REVERSED THE ARBITRATOR'S AWARD OF MARKET RENT WHEN THERE WAS SUBSTANTIAL EVIDENCE SHOWING THAT SANDHILL SATISFIED 25 *DEL. C.* § 7042(A)(2)……………………..........................24

A. Question Presented…………………………………………….24

B. Scope of Review…………..……………………………………..24

C. Merits of Argument……………………………………………24

1. The Statutory Framework……………………………………24

2. The Erroneous Application of the Rent Justification Act by the Superior Court…..27

a. The Rent Justification Act makes it clear that charging market rent protects a community owner's interest in receiving a fair return on its property while also protecting homeowners from unreasonable rent increases...............27

b. Sandhill's expenditure of $12,185 on an optional community improvement satisfies the modest burden imposed under Section 7042(a)………………………..29

c. Sandhill offered additional evidence that its expected return has declined……………………………………..34

d. Sandhill was able to increase its rent to the full market rate of $455 per month because it satisfied Section 7042(a)(2)……………………………………………...35

CONCLUSION 39

TABLE OF AUTHORITIES

CASE LAW

Bon Ayre Comm. Assoc. v. Bon Ayre Land, LLC,
2015 Del. LEXIS 99 (Del. Supr., Feb. 26, 2015) 11

Bon Ayre Comm. Assoc. v. Bon Ayre Land, LLC,
2016 Del. LEXIS 18 (Del. Supr., Jan. 12, 2016)...25

Bon Ayre Land, LLC v. Bon Ayre Community Assoc.,
149 A.3d 227 (Del. 2016) ....*passim*

December Corp. v. Wild Meadows Home Owners Ass'n,
2015 Del. LEXIS 304 (Del. Ch., Dec. 21, 2015)...11

December Corp. v. Wild Meadows Home Owner Ass'n,
2016 Del. LEXIS 336 (Del. Supr., July 12, 2016)...12, 26

Donovan Smith HOA v. Donovan Smith MHP, LLC,
190 A.3d 977 (Del. 2018) 4, 34

Falconi v. Coombs & Coombs, Inc.,
902 A.2d 1094 (Del. 2006) 21

Person-Gaines v. Pepco Holdings, Inc.,
981 A.2d 1159 (Del. 2009) 21

Tunnell Companies L.P. v. Greenwalt,
2014 Del. LEXIS 545 (Del. Supr., Oct. 14, 2014) 10, 25

STATUTES AND OTHER AUTHORITIES

25 *Del. C.* § 7001 *et seq* 6

25 *Del. C.* § 7007 7

25 *Del. C.* § 7021 7

25 *Del. C.* § 7040 ....8, 28

25 *Del. C.* § 7040 *et seq* 1, 4

25 *Del. C.* § 7042(a) ....*passim*

25 *Del. C.* § 7042(a)(1) 10, 25, 26, 28

25 *Del. C.* § 7042(a)(2) ....*passim*

25 *Del. C.* § 7042(c) ....*passim*

25 *Del. C.* § 7042(c)(1) ....*passim*

25 *Del. C.* § 7042(c)(7) ....*passim*

25 *Del. C.* § 7042(c)(1)-(8) 26, 32

25 *Del. C.* § 7043 ....9, 10

25 *Del. C.* § 7043(a) 9, 17

25 *Del. C.* § 7043(b) 9, 10, 18

25 *Del. C.* § 7043(c) 19

25 *Del. C.* § 7043(i) 19

25 *Del. C.* § 7044 .... 11, 24

NATURE OF PROCEEDINGS

This appeal asks this Court to correct the Superior Court's legally erroneous decision which failed to consider properly this Court's precedent and uphold the Arbitrator's well-founded rent justification decision. Sandhill Acres MHC, LC ("Sandhill") submitted substantial evidence in support of its market rent increase, and thus it was proper for the Arbitrator to award the entire market rent increase.

On August 11, 2017, the Sandhill Acres Home Owners Association (the "Appellee" or "SAHOA") on behalf of sixteen (16) residents representing thirteen (13) lots filed an Appeal of the Decision of the Arbitrator James P. Sharp (the "Arbitrator") dated July 17, 2017 (the "Arbitrator's Decision"). The Arbitrator's Decision granted Sandhill's market rent increase to $455 under 25 *Del. C.* § 7040, *et seq.* (the "Rent Justification Act").

On September 27, 2017, Appellee filed its Opening Brief on Appeal ("AEOB") in the Superior Court challenging the Arbitrator's legally correct interpretation and application of 25 *Del. C.* § 7042(a)(2). On October 27, 2017, Sandhill filed its Answering Brief on Appeal defending the Arbitrator's finding that Sandhill had satisfied its modest burden under § 7042(a)(2). On November 13, 2017, Appellee filed its Reply Brief on Appeal.

On November 30, 2017, one of the residents participating in the Superior Court Appeal sold his home and moved out of the Sandhill Acres Community. Then,

on April 30, 2018, while the Superior Court Appeal was still pending, another tenant moved out of the Sandhill Acres Community and sold her home. Of the sixteen residents who filed the Appeal, there are fourteen (14) remaining in the Community representing eleven (11) lots.

On September 13, 2018, the Delaware Superior Court entered a decision completely reversing the Arbitrator's Decision. On September 18, 2018, the Delaware Superior Court reissued its decision to correct the counsel of record for the parties on the decision (referred to as the "Superior Court Decision", and cited as "Supr. Op."), attached as Exhibit "A."

On September 25, 2018, Sandhill filed a motion for reargument to clarify the Superior Court Decision that completely reversed the Arbitrator's Decision which had, in part, awarded Sandhill the legally permissible consumer price index (the "CPI-U") rate, plus an uncontested portion of its marker rent increase. On October 2, 2018, Appellee filed its opposition to Sandhill's motion for reargument. On October 3, 2018, the Superior Court denied the motion for reargument and clarified that the Superior Court Decision did not reverse the award of the CPI-U, and that decision is attached as Exhibit "B."

On October 12, 2018, Sandhill filed its Notice of Appeal with this Court requesting a review of the legally erroneous Superior Court Decision. This is Sandhill's Opening Brief on appeal before this Court.

SUMMARY OF ARGUMENT

1. The Superior Court erred when it reversed the Arbitrator's Decision which awarded Sandhill's proven and uncontroverted market rent rate increase. The Superior Court disallowed an increase that would raise the rent to $455 per month even though the Appellee did not challenge two portions of the increase amount.[1] In the underlying arbitration and Superior Court Appeal, the Appellee acknowledges that Sandhill incurred water improvement costs, and as a result, by Appellee's own calculations, Sandhill incurred an expense of $7.93 per lot per month.[2] By making this concession, Appellee waived its right to contest at least $7.93 of the market rent increase Sandhill was seeking through 25 *Del. C.* § 7042(c)(7). As a result, it was legally erroneous for the Superior Court to reverse the Arbitrator's Decision that awarded these uncontested portions of the market rent increase. Thus, at the very least, this Court should reverse the Superior Court's Decision on the uncontested portion of the market rent increase.

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[1] One part of the uncontested portion is the CPI-U rate increase permitted as a matter of law. The Superior Court subsequently amended its decision and ordered that the CPI-U rate increase was permitted as a matter of law.

[2] Appellee's calculation is based on spreading the cost of this water improvement over all lots in the community on a per month basis. That allocation of costs is required when a community owner is passing through a capital improvement cost under 25 *Del. C.* § 7042(c)(1).

2. The Superior Court erred in its application of the Delaware Code and Delaware case law[3] when it reversed the Arbitrator's Decision permitting Sandhill to increase its monthly rent to the comparative market rate. This Court has interpreted 25 *Del. C.* § 7042(a) as simply putting forth two gatekeeping provisions that a community owner must satisfy in order to obtain a market rent increase. In *Bon Ayre II*, this Court held that a community owner's burden to satisfy the second gatekeeping provision is a modest one. *Bon Ayre II* at 235. Sandhill did more than enough to satisfy this modest burden to show that it had incurred costs "directly related to operating, maintaining **<u>or</u>** <u>improving</u> the manufactured home community."[4] Specifically, Sandhill disclosed invoices and pictures of the improvements it performed in Sandhill Acres, which decreased its expected return on the property for that year. (A-0154-0156.) Further, per the guidelines set forth under the Rent Justification Act, at the informal rent increase meeting, Sandhill informed the homeowners that due to its improvement costs its expected returns had declined. (A-0149-0150.) The homeowners were specifically told that the sewer costs had increased at a rate of $83 per month per lot and this effected the net

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[3] 25 *Del. C.* § 7040, *et seq.*; 25 *Del. C.* § 7042(a)(2); *Bon Ayre Land, LLC v. Bon Ayre Community Assoc.*, 149 A.3d 227 (Del. 2016) ("*Bon Ayre II*"); and *Donovan Smith HOA v. Donovan Smith MHP, LLC*, 190 A.3d 977 (Del. 2018) ("*Donovan Smith*").

[4] 25 *Del. C.* § 7042(a)(2) (emphasis added).

operating income ("NOI") of the Community.[5] These disclosures were sufficient to satisfy the second gatekeeping provision in the Rent Justification Act, and thus the Arbitrator's Decision is supported by substantial evidence and it was legally erroneous for the Superior Court to reverse his decision. Thus, this Court should reverse the Superior Court and affirm the Arbitrator's Decision.

[5] A-0292, 0295, 0297-0298 (Arb. Trans. at 51, 62, 69-75).

STATEMENT OF FACTS

A. THE PARTIES

Sandhill is a Delaware limited liability company whose business is managing and maintaining a manufactured housing community. Sandhill owns the manufactured housing community known as Sandhill Acres, a community subject to the Manufactured Homeowners and Community Owners Act, 25 *Del. C.* § 7001 *et seq.* (the "Manufactured Housing Act"), and the Rent Justification Act, which is included as part of the Manufactured Housing Act.

Appellee, SAHOA, is a Delaware non-stock membership corporation. The members of SAHOA are all homeowners in Sandhill Acres. The only lots remaining at issue in this Appeal are the 11 lots represented by the 14 residents who still reside in the Community and that SAHOA represented in the Arbitration.

B. BACKGROUND

Sandhill Acres consists of 128 manufactured home rental lot sites located outside Georgetown, Delaware. (A-0295.) The community is located close to the Delaware beaches, and resident homeowners, their family and their guests have easy access to Route 13, which provides for a quick trip to local Delaware businesses and to Salisbury, Maryland, a large regional retail shopping destination.

Sandhill leases the manufactured home lots in Sandhill Acres to the tenants, who own the home on the rental lot (collectively, the "homeowners"), and Sandhill

provides the property management infrastructure and services which support that leasing activity for the benefit of the homeowners.

When homeowners first enter the community, they sign rental agreements which set forth the basis of the lot rental agreement between the parties, including the fixing of the lot rent during the term of the rental agreement. Following the expiration of the rental agreement, the Manufactured Housing Act mandates that the rental agreement be renewed **automatically**, irrespective of the wishes of the manufactured home community owner, except that the rental agreement term may be modified by the community owner relating to the amount and payment of rent, 25 *Del. C.* § 7007, and that rent increases are allowed only once during any 12-month period. 25 *Del. C.* § 7021.

1. Implementation of Rent Justification Act

Historically, following the initial term of the agreed to rent by the community owner and the homeowner, the community owner was free, as a matter of its business judgment and market conditions, to fix rent and to increase the rent for homeowners whose rental agreements had expired, so long as the rent increased only once during any 12-month time frame.

Then, in the waning days of the 2013 Legislative session, the Delaware General Assembly passed and the Governor signed into law a newly created "rent justification" structure which required that before imposing the new annual rents for

expired lease terms, a community owner was required, in certain circumstances, to "justify" the rent that it would charge the community residents.

In balancing between the competing interests of protecting the homeowners from unreasonable and burdensome rent increases "while simultaneously providing for the need of [community owners] to receive a just, reasonable and fair return on their property,"[6] the Manufactured Housing Act, as originally passed and now as it remains even after having been amended several times, set forth the minimal burden a community owner must satisfy when justifying its increase in rent.

2. How a Rent Increase Must be Disclosed, Justified, and Implemented.

Implementing a rent increase above the CPI-U baseline requires a three-step process before the matter can be brought to the courts for final resolution. Those

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[6] 25 *Del. C.* § 7040. As disclosed in the Manufactured Housing Act itself:

> [T]he General Assembly seeks to protect the substantial investment made by manufactured home owners, and enable the State to benefit from the availability of affordable housing for lower-income citizens, without the need for additional state funding. The General Assembly also recognizes the property and other rights of manufactured home community owners, and seeks to provide manufactured home community owners with **a fair return on their investment.** Therefore, the purpose of this subchapter is to accommodate the conflicting interests of protecting manufactured home owners, residents and tenants from unreasonable and burdensome space rental increases **while simultaneously providing for the need of manufactured home community owners to receive a just, reasonable and fair return on their property**.

Id. (emphasis added).

steps are:

(i) Written notice of the rent increase, including the percentage of that increase above the current amount;

(ii) An informal meeting with the affected homeowners to discuss the rent increase and whether there is agreement on whether such increase has been justified; and

(iii) Non-binding arbitration when agreement has not been reached by the homeowners and the community owner on the justification offered for the rent increase.

See 25 *Del. C*. § 7043.

Only if there is **no** compromise reached between the homeowners **and** the community owner during this process is the Superior Court, and subsequently, this Court empowered to make the **only** binding determination of whether the community owner has created a record that shows it met its minimal burden under the Act to justify the rent increase sought and whether the arbitrator's decision is supported by that record and free of legal error.

The first step imposes on the community owner the obligation to send out notice at least 90 days before the effective date of the notice of increase greater than CPI-U, and schedule a meeting of all of the affected homeowners within 30 days of sending that notice. 25 *Del. C*. § 7043(a) and (b). It is that notice that sets into motion the justification processes, and sets up the ultimate jurisdiction of the Delaware Manufactured Home Relocation Authority (the "RTA") and, if required, the courts to become involved in the "justification" process. *Id.*

The second step is an informal meeting held to "discuss the reasons for the increase." 25 *Del. C.* § 7043(b). At that meeting, the community owner must show that it has not violated the Manufactured Housing Act, that the proposed increase is directly related to operating, maintaining, or improving the community, and that the increase is justified by any of the eight factors in § 7042(c). § 7042(a)(1)(2). In doing so, the community owner is obligated, in "good faith," to "disclose in writing all of the material factors resulting in the decision to increase the rent." *Id.* This placing "all the proverbial cards. . . on the table" is intended to provide sufficient information to the homeowners, so that the homeowners can decide to accept the justification offered and the proposed increase, or otherwise to help them "**settle their disputes** without involving the courts, saving on judicial economy." *Tunnell Cos., L.P. v. Greenwalt*, 2014 Del. LEXIS 545, at *17 (Del. Supr., October 14, 2014) (emphasis added).

Finally, within 30 days following that informal meeting, any "affected home owner who has not already accepted the proposed increase, or the homeowners' association on the behalf of 1 or more affected home owners who have not already accepted the proposed increase" may petition the RTA and seek the appointment of a lawyer "arbitrator" to conduct "nonbinding arbitration proceedings" between the parties. 25 *Del. C.* § 7043. Although the homeowners' association may file a petition, that petition can only be on behalf of those owners who authorize the

association to represent them in such a matter. *See December Corp. v. Wild Meadows Home Owners Ass'n*, 2015 Del. LEXIS 304, at *20 (Del. Ch., Dec. 21, 2015).

Following the conclusion of the non-binding arbitration process, any party, for any reason (or no reason at all) may appeal to the Superior Court for the County in which the manufactured housing community lies. 25 *Del. C.* § 7044.

Upon any appeal, the Superior Court must determine whether there is sufficient justification for the arbitrator's decision in the record created at arbitration and whether that arbitrator has committed any errors of law. 25 *Del. C.* § 7044. To manage the costs for both the homeowners and the community owner and to streamline and facilitate the Court's review of the matter, the Rent Justification Act provides for a limited merits-based review of the community owner's business decision to increase its rent. The appeal from the non-binding arbitration proceeding "is on the record." *Bon Ayre Comm. Assoc. v. Bon Ayre Land, LLC*, 2015 Del. LEXIS 99, at *9 (Del. Supr., Feb. 26, 2015).

Thus, while the burden of persuasion remains on the community owner, the statutory standard of review is only a preponderance of the evidence – whether it is more likely than not, based on the Court's independent review of the record created in the arbitration, that the community owner has satisfied the conditions of the Rent Justification Act and justified the rent increase based on one or more of the eight

permitted factors. *December Corp. v. Wild Meadows Home Owner Ass'n,* 2016 Del. LEXIS 336, at *18 (Del. Supr., July 12, 2016).

C. THE ARBITRATOR CORRECTLY FOUND THAT SANDHILL COMPLIED WITH THE RENT JUSTIFICATION ACT.

To obtain a fair return on its investment, Sandhill sought to increase its current monthly rent to the market rent rate which is statutorily permitted under the Rent Justification Act. To do so, Sandhill diligently and faithfully complied with the terms of the Rent Justification Act.

1. Sandhill's Market Rent is Justified under 25 *Del. C.* § 7042(c)(7).

Sandhill noticed and is pursuing a rent increase to attain a market rental rate at its community, Sandhill Acres.[7]

a. Sandhill Accepts the CPI-U Rate for a Portion of its Rent Increase.

Rather than seek to set its rent rate above market, as the Rent Justification Act allows, Sandhill decided to limit a portion of its market rent increase by accepting as part of its increase a portion that is statutorily permitted to all community owners – the CPI-U rate. That amount, at the time of the sending of the notice of rent increase, was 0.7%.[8] This amount is uncontested by Appellee and the Superior Court

[7] A-0008-061; A-0071-0118.

[8] A-0297 (Arb. Trans. 71-72); *see also* A-0183.

clarified that it would allow this legally permissible portion of the rent increase. Exhibit B.

Further, demonstrating Sandhill's good faith, rather than collecting the statutorily mandated Relocation Trust Fund Fee (the "RTA Fee") of $2.50 per month from the homeowners on top of the market rent, Sandhill chose to limit its monthly charges to only $455 per month. (A-0004.) Sandhill take $2.50 of that monthly rental payment and remits it in satisfaction of the monthly RTA Fee on a quarterly basis. Consequently, even after raising its rent to the market rate, Sandhill is not receiving that market rent rate because it is paying the homeowners' RTA Fee on the their behalf. This rent discount is uncontested by Appellee.

b. Sandhill Proves its Market Rent is $455 per Month.

During the community meeting and during the Arbitration, Sandhill set forth written and testimonial evidence of the market rent for the community which is a permitted justifying factor under Section 7042(c)(7).[9] Sandhill provided evidence of the market rent charged to seven new tenants that moved into the Community at $455 per month.[10] Sandhill also engaged Collier's International, an independent, nationally recognized Valuation Company to determine its market rent rate. Sandhill

[9] A-0156-0172; 0193-0208; 0216-0272.

[10] A-0171; A-0208; A-0291 (Arb. Trans. at 46); A-0293 (Arb. Trans. at 53); A-0298-0309 (Arb. Trans. at 76-120).

provided Appellee and all homeowners at the rent increase meeting with Collier's International's Fair Market Rent Analysis (the "Market Study") that determined the market rent was $455 per month.[11] Moreover, there was testimony not only from Collier's International, but also from SAHOA's homeowner witnesses who supported the conclusions of the Market Study.[12] Specifically, Robert Ray, a homeowner in Sandhill Acres, testified that Sandhill Acres was "nicer" than the comparable communities in the area.[13] That testimony confirmed that the market rent of $455 the expert presented was accurate because that rent rate falls appropriately within the range of the comparable communities rent rates.[14] Such proof met the minimal burden of Sandhill to show that it is entitled to the market rate for its rental increase.

Not surprisingly, Appellee does not contest the market rate, or the showing in

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[11] A-0215-0272.

[12] A-0291, 0293, 0298-0309, 0314 (Arb. Trans. at 46, 53, 76-120, 139-140).

[13] A-0314 (Arb. Trans. at 139-140).

[14] A-0246 and A-0255. The comparable market rates the expert obtains from the comparable communities are the currently charged rent rates. As explained by the expert, rents in manufactured housing communities raise 3% to 5% each year. A-0303 (Arb. Trans. at 96). Thus, from the start of the new renewal year, because the Rent Justification Act requires community owners to find rents being currently charged in comparable communities, the concluded market rental rate for a subject community is already 3% to 5% below the should-be market rent rate for that upcoming year.

the record that Sandhill made to demonstrate what the market rent rate per lot is at Sandhill Acres. Rather, SAHOA contends that Sandhill is not entitled to the market rent rate because it failed to satisfy one of the gatekeeping conditions of the Rent Justification Act. SAHOA is mistaken.

To meet the gatekeeper condition of Section 7042(a)(2) and show that the rent increase is "directly related to operating, maintaining or improving" the community, this Court has held that if a community owner can show that its original expected return has declined because its costs have gone up or that it has invested in its community, then the door is open to justify a rent increase on the factors.[15]

c. Sandhill Incurred An Expense That Affected Its Expected Return as Required by *Bon Ayre II.*

During the community meetings and at the arbitration, Sandhill provided sufficient information to satisfy *Bon Ayre II*'s "modest burden" on the community owner to show that it invested in its community. At slide 9 of its Sandhill's PowerPoint Presentation (the "Written Presentation") to homeowners, Sandhill disclosed that its costs had gone up such that its expected return on the property had declined.[16] Robert D. Ruais, the director of operations for the management company for Sandhill Acres, testified at Arbitration that he informed the homeowners at the

[15] *Bon Ayre II*, 149 A.3d at 234.

[16] A-0149 and A-0186.

community meeting: "I did talk about the fact that the water and sewer costs between 2012 and 2016 had gone up about $83 per lot per month. And I do remember also tying that with the concept that that meant that the NOI was down in that same period like, 50 – probably used the number $57."[17] In fact, SAHOA's own testimony confirmed that Sandhill is regularly maintaining and improving the septic system in the community which substantiates that the sewer costs have gone up.[18]

On slide 10 of the Written Presentation, Sandhill also specified that it chose to improve the water aesthetics in the community at a cost of $12,185.[19] On slide 11, Sandhill provided the homeowners with a copy of the invoices for the water improvement work reflecting the charge of $12,185.[20] Then, on slides 12 and 13, Sandhill provided the homeowners with actual pictures of the water improvement products that were purchased and installed.[21] Necessarily, if Sandhill did not perform this elective improvement, its expected return would have been $12,185 greater than it otherwise was at year end. Appellee acknowledges the cost of this

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[17] A-0295 (Arb. Trans. at 62).

[18] A-0313 (Arb. Trans. at 136); A-0315 (Arb. Trans. at 143-144); A- 0316 (Arb. Trans. at 147).

[19] A-0150; A-0187.

[20] A-0151; A-0188.

[21] A-0152-0153; A-0189-0190.

improvement and Sandhill adequate disclosure thereof.[22]

Thus, Sandhill more than adequately satisfied the second gatekeeping provision of Section 7042(a)(2) permitting it to seek an increase based on the factors under Section 7042(c), and the Arbitrator's Decision finding that it did so is free of legal error, so the Superior Court Decision should be reversed.

d. Sandhill Gives Appropriate Notice of its Rent Increase

Just as any landlord in a free market economy would desire and as allowed by the Rent Justification Act, Sandhill sought to receive fair market rent by increasing the monthly lot rent above CPI-U. It is the receipt of market rent that allows a community owner of a rental community to receive a "just, reasonable and fair return" on his/her property as intended by the Rent Justification Act. Thus, on January 30, 2017 and March 31, 2017, in accordance with 25 *Del. C.* § 7043(a), Sandhill sent all affected homeowners in Sandhill Acres a notice of rent increase above the CPI-U.[23] Sandhill also notified, as mandated by the Rent Justification Act, the RTA and SAHOA, the only homeowners association who had registered with the RTA by the date of the second rent increase notice. (A-0063, A-0120.)

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[22] AEOB at A-0449-0501, A-0510, and A-0512.

[23] A-0009-0061, A-0072-0126.

e. Sandhill, In Good Faith, Disclosed the Basis of its Rent Increase to the Market Rate of $455.

On February 9, 2017 and April 18, 2017, in accordance with 25 *Del. C.* § 7043(b), meetings were held between Sandhill and the affected homeowners.[24] During these meetings, the homeowners were presented with documentation, in writing, about **all** of the material factors resulting in the decision to increase the rent, including Sandhill's Written Presentation and Collier International's Market Study.[25] Indeed, Sandhill went beyond its statutory obligation, by providing copies of the Written Presentation and the Market Study, and an oral presentation – which included questions and answers that allowed **all** affected homeowners in attendance to know and understand what was provided in the printed Written Presentation.[26] The homeowners asked questions about Sandhill's increase costs, and Sandhill openly answered those questions explaining that its expected return had declined because of its $12,185 expense on the water improvement project as well as the overall cost of the sewer system increasing at a rate of $83 per lot per month resulting in a decrease of the NOI of $57 per lot per month.[27]

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[24] A-0009, A-0131.

[25] A-0141-0279.

[26] A-0141-0173, A-0178-0210, A-0216-0279; A-0291-0294 (Arb. Trans. at 48-57).

[27] A-0295 (Arb. Trans. at 61-62).

D. THE ARBITRATION PROCEEDINGS

On or about March 9, 2017 and May 8, 2017, SAHOA filed two petitions for arbitration under 25 *Del. C.* § 7043(c) on behalf of 16 residents, 13 lots.[28] And 30 days after the final informal meeting, no other homeowner at Sandhill Acres had filed a petition.[29]

The RTA appointed James P. Sharp, Esq. as the Arbitrator to undertake the non-binding arbitration proceedings. On May 23, 2017, the arbitration was conducted. Sandhill provided evidence through a Written Presentation and a Market Study to establish its market rent rate. That Written Presentation and the detailed explanation presented with it, confirmed through testimony of fact witnesses at arbitration, informed Appellee that Sandhill incurred a cost of $12,185 which negatively impacted its expected return on the property, and further that its sewer costs increased by $83 per lot per month, resulting in a decreased NOI at a rate of $57 per lot per month. These documents and testimony met Sandhill's minimal burden to demonstrate compliance with the statutory gatekeeper conditions and constitute substantial proof of the market rent it noticed.

[28] The two separately filed petitions were consolidated at the requests of the parties and with the approval of the RTA.

[29] Pending the Superior Court's Decision two of these homeowners on two separate lots sold their homes and moved out of the Community. Thus, there are only 14 residents on 11 lots remaining in this Appeal, and the other homeowners are statutorily precluded from challenging the rent increase. 25 *Del. C.* § 7043(i).

On July 17, 2017, after the submission of written closing arguments, the Arbitrator found that Sandhill was entitled to a CPI-U increase of 0.7% plus further "adjustments necessary to bring each of the affected homeowners' lot monthly rental rates to $455.00." (A-0536-0537.) The Arbitrator concluded it was "clear that the water filtration system was clearly a benefit to the community and the cost thereof is related to improving Sandhill Acres." (A-0522.) The Arbitrator thus found that the water improvement cost alone, which decreased Sandhill's expected return by $12,185, was sufficient to satisfy the threshold requirement of § 7042(a)(2). (A-0524.) Then, the Arbitrator found the expert's testimony and the market rent study reliable, and it was even supported by the homeowners that testified at arbitration, which established the market rent was $455 per month. As a result, the Arbitrator awarded the market rent rate increase to $455 per month. The Arbitrator's Decision was fully supported and amply justified by the record created before the Arbitrator, and, as the decision itself reflects, there are no errors of law which would in any way defeat the showing in the record that all obligations under the Rent Justification Act had been met and that the market rent had been justified. As a result, it was legally erroneous for the Superior Court to reverse the Arbitrator's Decision.

ARGUMENT

I. THE SUPERIOR COURT ERRED AS A MATTER OF LAW WHEN IT DISALLOWED ALL OF SANDHILL'S RENT INCREASE EVEN THOUGH SAHOA WAS NOT CHALLENGING TWO PORTIONS OF THE RENT INCREASE.

A. Question Presented.

Whether the Superior Court erred as a matter of law when it disallowed all of Sandhill's Rent Increase even though SAHOA was not challenging the portions of the rent increase related to the CPI-U rate of 0.7% and $7.93 of the market rent adjustment as SAHOA felt that portion was justified by the water improvement cost.[30]

B. Scope of Review.

This Court reviews the Superior Court's decision for substantial evidence and legal errors. Substantial evidence is more than a mere scintilla but less than a preponderance of the evidence. *Falconi v. Coombs & Coombs, Inc.*, 902 A.2d 1094, 1098 (Del. 2006). "Errors of law are reviewed *de novo*." *Person-Gaines v. Pepco Holdings, Inc.*, 981 A.2d 1159, 1161 (Del. 2009).

C. Merits of Argument.

The Superior Court erred in simply reversing the Arbitrator's Decision. The Arbitrator awarded an increase of rent to $455 per month. This increase was

[30] AEOB at A-0499-0510.

comprised of a CPI-U rate increase of 0.7% plus a further adjustment to reach the proven and unrebutted market rent amount of $455 per month. At arbitration and again on Appeal, SAHOA did not challenge the 0.7% CPI-U rate increase and an additional $7.93 of market rent adjustment. (AEOB at A-0484, 0499-0510.) SAHOA only challenged the portion of rent that exceed those two adjustment amounts. (*Id.*) The Superior Court reversed the Arbitrator's Decision permitting an increase based on CPI-U and market rent. Later, the Superior Court clarified it did not reverse the Arbitrator's ruling on the CPI-U rate increase; yet, it neglected to consider the portion of the market rent increase not challenged by SAHOA.

At arbitration, Sandhill proved that market rent for the Sandhill Acres Community is $455 per month. Sandhill presented evidence through a Written Presentation as well as live testimony that new homeowners moving into the Community were signing leases at a rate of $455 per month.[31] Sandhill also presented the Market Study from Royce Rowles of Colliers International who completed a comparative analysis required by the Rent Justification Act and concluded that the market rent rate for Sandhill Acres was $455 per month. (A-0215-0272; A-0298-0309.) In fact, SAHOA's own witnesses testified that Sandhill Acres was like the communities Mr. Rowles identified and dissimilar to the

[31] A-0171; A-0208; A-0291 (Arb. Trans. at 46); A-0293 (Arb. Trans. at 53).

communities Mr. Rowles noted were distinguishable.[32] Mr. Rowles adjusted the comparables rent rates to account for the differences between the comparable communities so that he could determine the appropriate rent rate for that market. (A-0254-0255.) SAHOA's witnesses gave testimony that confirmed Mr. Rowles adjustments were appropriate.[33] Thus, the market rent rate of $455 was uncontested.

On Appeal, SAHOA specifically noted that it was not challenging CPI-U of 0.7% as well as $7.93 of the market rent rate adjustment. (AEOB at A-0484, 0499-0510.) Appellee confirmed that "SAHOA never argued that the [water filtration] expense cannot be used as evidence to show that a *portion* of the rent increase is 'directly related' under Section 7042(a)(2)." (AEOB at A-0500.) Given that SAHOA was not challenging that portion of the market rent increase, Appellee waived its right to contest $7.93 of the market rent increase Consequently, because SAHOA conceded Sandhill is entitled to $7.93 of the market rent increase, it was legally erroneous for the Superior Court to reverse the Arbitrator's Decision. As a result, this Court should reverse the Superior Court on its reversal of the Arbitrator's Decision awarding $7.93 of the market rent increase.

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[32] A-0314 (Arb. Trans. at 139-140).

[33] A-0314 (Arb. Trans. at 139-140).

II. THE SUPERIOR COURT ERRED AS A MATTER OF LAW WHEN IT REVERSED THE ARBITRATOR'S AWARD OF MARKET RENT WHEN THERE WAS SUBSTANTIAL EVIDENCE SHOWING THAT SANDHILL SATISFIED 25 *DEL. C.* § 7042(A)(2).

A. Question Presented.

Whether it was legal error for the Delaware Superior Court to reverse the Arbitrator's award of market rent of $455 per month when the Arbitrator's Decision was supported by substantial evidence and free of legal error.[34]

B. Scope of Review.

Title 25, Chapter 70, Section 7044 indicates that appeals of rent increase arbitrations are "on the record", and the Court must examine the record to determine "whether the record created in the arbitration is sufficient justification for the arbitrator's decision and whether those decisions are free from legal error." When such appeals involve issues of statutory interpretation and related case law, the standard of review is *de novo*. *Bon Ayre II* at 233.

C. Merits of Argument.

1. The Statutory Framework

The Rent Justification Act permits a community owner to increase its lot rent yearly, without justification, if the rent increase is less than the statutory chosen base,

[34] Sandhill's Answering Brief on Appeal at A-0706-0721.

the three year average of the Consumer Price Index applicable to this area, known as or "CPI-U." 25 *Del. C.* § 7042(a). If the community owner wishes to increase rent in an amount above that base, this Court has confirmed that Section 7042(a) allows it to do so. Indeed, a "community owner may increase rent for any and all 12 month period rental agreements in an amount greater than the CPI-U only if the community owner can demonstrate the increase is justified." *Bon Ayre Comm. Assoc. v. Bon Ayre Land, LLC,* 2016 Del. LEXIS 18, *13 (Del. Supr., Jan. 12, 2016) (*quoting Tunnell Companies L.P.*, 2014 Del. LEXIS 545).

A rent increase greater than CPI-U is "justified" if a community owner can meet two "gatekeeping conditions" and one "substantive condition" provided under the Act. 25 *Del. C.* § 7042(a). The gatekeeper conditions that the community owner must "demonstrate" are

> Gatekeeper 1: The community owner, during the preceding 12-month period, must not be found to be in violation of any provision of the Manufactured Housing Act that "threatens the health or safety of the residents, visitors or guests that persists for more than 15 days," beginning from the day the community owner received notice of such violation.
> Gatekeeper 2: The rent increase must be "directly related to operating, maintaining or improving the manufactured home community[.]"

25 *Del. C.* § 7042(a)(1)(2); see also *Bon Ayre Comm. Assoc.,* 2016 Del. LEXIS 18, at *12.

The substantive condition that the community owner must "demonstrate" is:

> Substantive Condition: The rent increase is "justified" by one or more of

the factors listed in 25 *Del. C.* § 7042(c)(1)-(8).

25 *Del. C.* § 7042(a)(2). Under this substantive condition, there are eight "factors," or bases which a community owner may choose to use to "justify" the increase in rent. 25 *Del. C.* § 7042(c). The Rent Justification Act specifically allows "[o]ne or more" of these factors to be used to justify the rent increase. 25 *Del. C.* § 7042(c).

For its rent increase, Sandhill is relying only on factor seven: "For purposes of this section, 'market rent' means that rent which would result from market forces absent an unequal bargaining position between the community owner and the home owners." 25 *Del. C.* § 7042(c)(7).

The community owner's justification obligation under the Rent Justification Act is minimal, requiring only that the community owner demonstrate that it has more likely than not complied with Section 7042(a)(1) and (2) and it has met at least one of the eight factors in Section 7042(c). 25 *Del. C.* § 7042(a)(1)(2); *December Corp.* 2016 Del. LEXIS 336, at *18. A community owner who meets its minimal burden under the Rent Justification Act has the right, as it did before the implementation of the Act, to increase its monthly rent amount. 25 *Del. C.* § 7042(a). The statute states that "[a] community owner **<u>may</u>** raise a home owner's rent. . . provided the community owner can demonstrate the increase is justified under the Act." 25 *Del. C.* § 7042(a) (emphasis added)).

2. The Erroneous Application of the Rent Justification Act by the Superior Court.

The Superior Court incorrectly summarized that "Sandhill Acres argues that the proposed rent increase is based upon installing an improved water filtration system and is directly related to improving the community." (Supr. Op., Ex. A at 4.) Instead, Sandhill's rent increase is based on market rent. Sandhill simply used its water improvement expense, among other information, to satisfy the second gatekeeping provision of the Rent Justification Act. Despite that clear finding of the Arbitrator, the Superior Court mistakenly concluded that the Arbitrator awarded the market rent increase "because Sandhill Acres spent $12,185 to improve the water filtration system of the Sandhill Acres Manufactured Home Community." (Supr. Op., Ex. A at 1.) Yet the Arbitrator's Decision clearly states that market rent was awarded because of the number of new homeowners moving into the Community paying $455 per month, and because the homeowners that testified supported the expert's observations regarding comparable communities. (A-0464-0465.) The Superior Court's error arises from the misinterpretation of the arguments and record below as well as a misapplication of the law.

a. The Rent Justification Act makes it clear that charging market rent protects a community owner's interest in receiving a fair return on its property while also protecting homeowners from unreasonable rent increases.

The General Assembly wanted to "provid[e] for the need of manufactured

home community owners to receive a just, reasonable and fair return on their property." 25 *Del. C.* § 7040. At the same time, the Legislature sought to protect "residents and tenants from unreasonable and burdensome space rental increases[.]" 25 *Del. C.* § 7040. To maintain a fair balance, the Legislature set forth eight factors by which community owners can raise their rents to receive a fair return on their property while simultaneously protecting homeowners from unreasonable and burdensome rent increases. 25 *Del. C.* § 7042(c). It is clear based on Section 7042(c)(7) that the Legislature believed that the ability to charge market rent protects the community owners' right to receive a fair return on the property and is not unreasonable or burdensome on the homeowners. Market rent adjustments also provide protection to homeowners by limiting community owners to market prices and allowing them to limit increases only to those homeowners paying below fair market rent.

Still, the Legislature clearly intended to prevent negligent owners of derelict communities from accessing the rent justification factors provided for in the Rent Justification Act. Such community owners are not entitled to a fair return on their property, because such a return is not just and reasonable where the community owner has neglected its community. Thus, derelict owners are specifically limited to only increasing their rent by the CPI-U rate. This limitation is clearly set forth in Section 7042(a)(1) which requires community owners to have a "clean bill of health

in terms of safety violations." *Bon Ayre II* at 230. Next, the Rent Justification Act prevents negligent community owners who are not adequately operating, maintaining, or improving their communities from obtaining a rent increase above CPI-U. § 7042(a)(2). This second statutory hurdle requires a community owner to show that it has incurred a cost that has impacted its expected return on the property. *Bon Ayre II* at 234. Sandhill made this showing at Arbitration.

b. Sandhill's expenditure of $12,185 on an optional community improvement satisfies the modest burden imposed under Section 7042(a).

The second gatekeeping provision at Section 7042(a)(2) requires that the "proposed rent increase [be] directly related to operating, maintaining or improving the manufactured home community, and justified by 1 or more factors listed under subsection (c) of this section." In *Bon Ayre II*, this Court explained that in order to show the increase is "directly related to operating, maintaining or improving the manufactured home community[,]"[35] the community owner must show:

> [I]ts original **expected return** has declined, because the cost side of its ledger has grown. If a community owner can show that its costs have gone up, that opens the door to a rent increase based on § 7042(c)'s factors, including

[35] The community owner in the *Bon Ayre II* case submitted no evidence to satisfy Section 7042(a)(2), but instead argued that the "and" in the Act should be read as an "or". This Court rejected that argument because the Act clearly established three conditions that need to be satisfied to justify a rent increase. Here, through the entire process, Sandhill has submitted evidence to satisfy the independent condition of Section 7042(a)(2).

> market rent. If a community owner invests in its development, and therefore has "improve[d]" the community, it can also reap the reward from that investment through higher-than-inflation rent increase.

Id. at 235 (emphasis added). There are three ways to satisfy this second provision: (1) incur an increase in operating expenses, or (2) incur an increase in maintenance expenses, or (3) incur an investment expense in the community. If the community owner incurs an investment expense in its community, it may obtain a "higher-than-inflation rent increase". *Id*. Importantly, this Court noted "[t]his statutory requirement is a **modest** one, which only requires the community owner to produce evidence **suggesting** that the 'expected return' on its 'property' has declined." *Bon Ayre II* at 235-236 (emphasis added). Once this modest burden has been met, the community owner can justify an increase based on all factors set forth in Section 7042(c). *Id*.

Here, Sandhill has irrefutably shown that it incurred an investment expense in Sandhill Acres. Specifically, Sandhill spent $12,185 to improve Sandhill Acres. At arbitration, Gary Creppon was admitted as an expert on the water system in Sandhill Acres.[36] He explained that the water is tested daily in Sandhill Acres and that the State tests the water quality monthly.[37] Mr. Creppon confirmed that there have been

[36] A-0285 (Arb. Trans. at 24.)

[37] A-0285 (Arb. Trans. at 22-23).

no violations for the water system over the last year.[38] Contrary to what the Superior Court concluded, Mr. Creppon confirmed that Sandhill elected to update and improve parts of its water filtration system, not because it was required to do so, but because Sandhill desires to continually improve its Community. (A-0288 (Arb. Trans. at 34)); *see also* (A-0285 (Arb. Trans. at 22) (testifying that Sandhill "started making improvements, trying to make improvements to actually better the community at all times.").) The Arbitrator specifically found that "water quality issues had not been present in the past year." (A-0457.) Having incurred this improvement expense, this Court has said "it can also reap the reward from that investment through higher-than-inflation rent increase." *Bon Ayre II* at 235.

The Superior Court failed to give the proper weight to this water improvement cost. The Superior Court stated that the Arbitrator reasoned "that the community had experienced problems with the water and that the improved water filtration system addressed those problems and thus benefited the community." Supr. Op. at 7 at Exhibit A. Yet, the Arbitrator specifically concluded that "the water quality issues had not been present in the past year." (A-0522.) Thus, the water improvement completed in the community was a direct reduction of Sandhill's expected return because it was an elective improvement made to the community at the expense of Sandhill, not simply a cost of maintenance or operation for the

[38] A-0285 (Arb. Trans. at 24).

community. The Superior Court concluded that "[i]t is not merely enough for a community owner to show that it has incurred some costs." Supr. Op. at 10 at Exhibit A. However, Sandhill did not just "incur some cost", it incurred an elective improvement expense that reduced its expected return on the community. The Superior Court failed to give this expenditure the proper consideration, and furthermore, failed to defer to the Arbitrator who heard the firsthand account of how the expenditure affected the community.

In making such a conclusion, the Superior Court committed legal error by failing to consider the Rent Justification Act as a whole. There are eight factors by which a community owner can increase rent. Clearly, the Legislature wanted the community owner to incur an expense when seeking a rent increase. Among the eight increase justification factors, the community owner must show an improvement expense, a repair expense, or an increase in tax expenses, utilities costs, insurance and financing expenses, and operating and maintenance expenses as Section 7042(c)(1)(2)(3)(4)(5) and (6). The Legislature, each year, then allows a community owner who incurs these investments costs or expenses to increase its rent above CPI-U.

Consistent with this Legislative intent, this Court in *Bon Ayre II* explained that to show the increase is directly related to the operating, maintaining or improving the community, a community owner must show that its costs have gone up or that it

has invested in its development. *Bon Ayre II* at 235. The Legislative intent behind factors (c)(1)(2)(3)(4)(5) and (6) is consistent with this Court's interpretation of § 7042(a)(2) in *Bon Ayre II*. That is, if a community owner is seeking to increase its rent above CPI-U, it must show an increase in expenditures by showing that its costs incurred in maintaining and operating the community have risen, or that it incurred a cost of an improvement in the community. Here, Sandhill made a significant improvement in its community and it did not seek to pass that cost onto all of homeowners under § 7042(c)(1). Instead, it relied on its Market Study and sought to increase its rent for specific homeowners to the determined market rent rate under § 7042(c)(7), using the water improvement cost to satisfy § 7042(a)(2).

As this Court contemplated and consistent with the Legislative intent, by investing in its community, Sandhill has shown that its expected return on its property declined. Specifically, Sandhill's expected return decreased by $12,185. This expense alone satisfies the modest burden imposed by this Court so much so that Appellee acknowledges that Sandhill's improvement costs resulted in a $7.93 reduction in expected returns per lot per month. It is thus evident that this noncompulsory investment expense directly reduced Sandhill's expected return by $12,185. This investment alone, which was fully pictured and explained in the Written Presentation as well as discussed at the rent increase meeting, is enough to show that the expected return on Sandhill's property has declined, and thus satisfies

the requirements of Section 7042(a)(2). Thus, the Arbitrator correctly found that Sandhill satisfied its modest burden of Section 7042(a)(2) as the written record reflects that Sandhill testified and produced an invoice and photographic evidence that establishes it incurred a cost of $12,185, and that such costs was not a necessary repair, but was an investment in the community.[39] It was legally erroneous for the Superior Court to reverse the well-founded decision of the Arbitrator.

c. Sandhill offered additional evidence that its expected return had declined.

Even if water improvement is not enough to satisfy Sandhill's modest burden, which it is, there was more testimony that Sandhill's expected return on its property is down. Although SAHOA neither requested Sandhill's books and records nor made a demand to the Arbitrator for such materials,[40] Sandhill also informed SAHOA through the Written Presentation that its costs had gone up causing its expected return on its property to decline. (A-0149, A-0186.) Sandhill's Director of Operations, Robert Ruais, testified that since the community was purchased in 2012,

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[39] A-0292 (Arb. Trans. at 52); A-0141-0173; A-0178-0210.

[40] *Donovan Smith HOA,* 190 A.3d 997, at *3 (concluding that "the outcome could be quite different, especially if the homeowners fairly demand discovery of the community owner's books and records relevant to the question of whether the proposed above-inflation rent increase is 'directly related to operating, maintaining or improving the manufactured home community' and the arbitrator fails to require production of those records.").

the NOI was down by $57.00 per lot per month and that sewer costs have gone up at a rate of $83.00 per lot per month.[41] And this information was provided to the SAHOA at the rent increase meeting through the Written Presentation and verbal explanation.[42] In fact, SAHOA's own testimony confirmed that Sandhill is regularly maintaining and improving the septic system in the community substantiating the increased sewer costs.[43] Thus, Sandhill presented more than adequate evidence to show that its costs had gone up and that its expected return on its property has declined in satisfaction of the second gatekeeping condition of Section 7042(a)(2).

d. Sandhill was able to increase its rent to the full market rate of $455 per month because it satisfied Section 7042(a)(2).

Consistent with *Bon Ayre II*, the Arbitrator found "that, once this hurdle is cleared, the Landlord is not limited in increasing the rent by simply the amount of

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[41] A-0295 (Arb. Trans. at 62); A-0297 (Arb. Trans. at 70-71); A-0298 (Arb. Trans. at 73-75).

[42] A-0003; A-0292 (Arb. Trans. at 51); A-0295 (Arb. Trans. at 62); A-0141-0173; A-0178-0210. The Superior Court concluded it could not consider this evidence because the Arbitrator indicated that he did not base is his decision on this evidence. Yet, because the evidence was provided to the homeowners at the meeting and at arbitration, and the homeowners never demanded more evidence, it is part of the record, and the complete record must be considered when this Court determines if there is substantial evidence supporting the Arbitrator's Decision. Further, the description provided in the Written Presentation and the discussion held with it satisfies the disclosure obligations in the Rent Justification Act.

[43] A-0313 (Arb. Trans. at 136); A-0315 (Arb. Trans. at 143-144); A-0316 (Arb. Trans. at 147).

the water filtration expense." (A-0524.) SAHOA has argued that the cost of this improvement to the water system was too minimal to show that the rent increase was directly related to operating, maintaining, or improving the manufactured home community as required by Section 7042(a)(2). However, neither the Legislature nor this Court has specified the amount a community owner must invest in its community or the amount a community owner's expected return must decline by in order for that community owner to justify a rent increase above the CPI-U rate. If the Legislature had intended to limit a conscientious community owner's right to receive a "fair return" on its property, it could have easily accomplished that purpose by simply stating that community owners may only receive a fixed profit margin, or that they may only increase rent when their original investment returns decreased. Yet, the Legislature did not do that, and nothing in the Rent Justification Act supersedes the discretion of the private enterprise of a community owner with such specific and intrusive restrictions. Rather, the Legislature provides that the competing interests of community owners and homeowners are both protected in allowing a justification of rent to the market rent rate.

Sandhill believes SAHOA will go as far as to argue that the improvement investment expense must be in the same amount as the sum total of the increase sought to reach the market rent. However, that contention is belied by the actual terms of the Rent Justification Act and if adopted, would make any application under

Section 7042(c)(7) meaningless. In practice, there would be no provision for market rent increases applicable only to those homeowners paying less than market rent. The only means open for a community owner to increase the rent to the market rate would be to complete an investment improvement project that would justify the specific amount of that increase, then apply that amount to all homeowners as a pass through on a capital improvement through Section 7042(c)(1). This would result in **all** homeowners experiencing a rent increase and thus, as in this case, many would be forced to pay an amount greater than market rent. There would be no reason for the Legislature to have provided for a standalone market rent adjustment through Section 7042(c)(7) if they did not intend to provide a method by which a community might raise the rent of a limited number of homeowners to a fair market price. The only way of giving meaning to Section 7042(c)(7), and to the complete Rent Justification Act, is to hold that a community owner is not required to undertake an improvement project of equivalent cost of their proposed rent adjustment if that adjustment is intended only as a market rent adjustment.

Here, the Arbitrator gave meaning to all of the provisions of the Rent Justification Act and properly awarded Sandhill the CPI-U rate increase, the $7.93 portion of the market rent adjustment uncontested by SAHOA, and a further adjustment to bring all, now 11, lots monthly rent up to the reasonable rent rate of market rent. The Arbitrator's Decision was supported by substantial evidence and

free from legal error. In reviewing that Decision, the Superior Court failed to give proper weight to the Rent Justification Act as a whole, and in doing so, it limited the jurisprudence of this Court which allowed Sandhill to increase its rent above CPI-U if it showed that its rent increase is directly related to operating, maintaining, **or improving** its community. Rather than giving weight to that third factor as it is clearly laid out in the Rent Justification Act and provided for in this Court's *Bon Ayre II* decision, the Superior Court concluded that the elective improvement expense which reduced the expected return for of the property did not satisfy Sandhill's showing under § 7042(a)(2). In so doing, the Superior Court has imposed a burdensome restriction on community owners trying to receive fair market rent on their property and removed a protection for homeowners who, under § 7042(c)(7) would be asked only to pay no more than fair market rent. The Superior Court Decision is therefore legally erroneous and should be reversed and the Arbitrator's Decision should be affirmed.

CONCLUSION

For all these reasons, Sandhill respectfully requests that this Honorable Court reverse the Superior Court and affirm the Arbitrator's Decision.

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