

# **WORKING OR NOT: CHALLENGES IN ENFORCING COASTAL VACATION RENTAL REGULATIONS**

Because San Luis Obispo County is a tourist destination, many property owners, especially in coastal communities, make their houses or condominiums available for short-term vacation rentals. While such actions are subject to both county land use ordinances and taxes, individual landlord actions can conflict with overall community goals. In 2013 San Luis Obispo County updated its land use ordinances related to vacation rentals to address these concerns. This report examines how those ordinances are currently being enforced and opportunities for improvement.

## **INTRODUCTION**

A vacation rental is when property owners rent their property for a short duration, less than 30 days and often a week or less. Such rentals can positively impact communities in many ways: they provide owners with additional income, open a community to more tourism and generate tax revenue for the county. Such rentals can also negatively impact the tone of a community: transient visitors may create noise or parking issues; frequently rented properties can change the feel of the neighborhood; and unlicensed rentals may deprive local governments of income even as they impact requirements for local services.

This investigative report evaluates the benefits and impacts to determine if vacation rentals, as managed in the County of San Luis Obispo, are consistent with the stated goals of the county land use ordinances and if pertinent laws and tax policies are being enforced. This report focuses on the coastal areas of Avila Beach, Cambria and Cayucos which are subject to the most detailed county restrictions. However, similar issues may apply to other unincorporated areas of the county since all vacation rentals must be licensed. This would include such popular tourist destinations as Oceano, Los Osos and the Paso Robles wine country.

## **ORIGIN**

This case was initiated by the County Committee of the 2014-2015 San Luis Obispo County Grand Jury (Grand Jury) of its own volition and not from a complaint.

## **AUTHORITY**

*California Penal Code section 925* authorizes the Grand Jury to investigate and report on the operations, accounts and records of a county officer, department or function.

## **METHOD**

The Grand Jury interviewed relevant members of the county staff (including individuals in planning, code enforcement, business licenses and taxation); members of the Sheriff's Department responsible for responding to resident complaints; representatives of advisory councils in Avila Beach, Cambria and Cayucos; citizens from affected communities and a property manager. It examined pertinent county ordinances and reports, as well as previous input from advisory councils regarding revisions to the ordinances. It reviewed online and printed listings for vacation rentals in coastal communities and compared them against official county records of licensed vacation rentals.

## **BACKGROUND**

The Coastal Zone Land Use Ordinance covering vacation rentals was first adopted in 2003 and was most recently revised and approved in November 2013 (*San Luis Obispo County Code 23.08.165*). This set of ordinances defines residential vacation rentals, rationale for regulating them, permit requirements, common regulations, complaint processes and taxation requirements. The San Luis Obispo County Board of Supervisors (Board) made these revisions after a lengthy process of community input. The ordinance notes that "the Board of Supervisors find that residential vacation rentals have the potential to be incompatible with surrounding residential uses, especially when several are concentrated in the same area, thereby having the potential for

a deleterious effect on the adjacent full-time residents. Special regulation of residential vacation rentals is necessary to ensure that they will be compatible with surrounding residential uses and will not act to harm and alter the neighborhoods they are located within.”<sup>1</sup>

This report examines how these ordinances are impacting the affected communities after more than a decade of being in effect.

## **NARRATIVE**

To assess the impact of vacation rentals on local communities, the Grand Jury first determined what is meant by a vacation rental. It then reviewed and assessed potential problems that may relate to vacation rentals in our county. This includes noise and parking complaints, unlicensed vacation rentals and loss of resulting taxes to the county, issues with obtaining or using vacation rental business licenses, and the potential misuse of minor use permits for vacation rentals. Finally, the Grand Jury focused on areas where the county could better support existing county goals and policies.

## **DEFINING VACATION RENTALS AND THEIR STATUS**

### ***Definition***

A residential vacation rental occurs when the owner of a residence makes that property available for short-term rentals, defined as less than 30 days. Actions that do not constitute a vacation rental may include: using a property as a second home that is not occupied full time; loaning the use of a house occasionally to friends or relatives or renting a house for a continuous term of more than 30 days.<sup>2</sup>

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<sup>1</sup> Page 8-75, *Coastal Land Use Ordinance*, 23.08.165 <http://www.slocounty.ca.gov/Assets/PL/Ordinances/Title+23+-+Coastal+Zone+Land+Use+Ordinance/Title+23+Coastal+Zone+Land+Use+Ordinance.pdf>

<sup>2</sup> The county vacation rental ordinance does not specify if there is a minimum threshold for short-term rentals that would require being licensed. Under U.S. tax code, income from a residence rented for fewer than 15 days in a year is not subject to taxation. For the purpose of this report, the focus is on owners who are seeking repeat short-term engagements and demonstrate that through the active listing of their property.

### ***Scope of Vacation Rentals***

At the end of calendar year 2013, there were 849 licensed vacation rentals<sup>3</sup> in San Luis Obispo County generating over \$9 million in taxable revenue. Avila Beach (51), Cambria (351) and Cayucos (265) account for nearly 80% of these units. The total number of vacation rentals continues to grow each year. In 2012, 47 new rentals were licensed; in 2013, 57 were added; and as of early December 2014, 48 had been added. Even though each year some property owners drop their vacation rental status, the overall number of licensed vacation rentals in these three communities increased by 67 between 2010 and the end of 2013.

### ***Impact of Vacation Rentals***

Vacation rentals benefit the community in many ways. For the homeowner, the rental may serve as a source of income or a supplemental source of money that makes a second home affordable. For the California Coastal Commission, vacation rentals encourage access to and use of our coastline. In the county, vacation rentals also create a stream of revenue and taxes—state sales tax, business license fees, county transient occupancy taxes and local tourism business special district assessments designed to support tourism. At the same time, the county recognizes an excessive presence of vacation rentals have the potential to damage the community and alter the neighborhoods.

### ***Permit Requirements***

For a home to be licensed as a residential vacation rental in Avila Beach, Cambria or Cayucos, the owner must obtain three items from the county: a zoning clearance, business license and transient occupancy tax certificate. If a zoning clearance cannot be obtained, an owner can apply for a minor use permit. In addition, the owner must demonstrate proof from the local water or sewage disposal provider that the agency has been informed of the property's intended use and can accommodate this use.

Additional requirements relating to zoning clearances for vacation rentals include:

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<sup>3</sup> This report uses vacation rental counts based on the number of units holding transient occupancy tax certificates. This may not always match the count of units shown on planning maps as licensed vacation rentals.

- Avila Beach. Must be at least 50 feet away from any other existing vacation rentals,<sup>4</sup> including condominium units.
- Cambria. Must be at least 200 feet away from another existing vacation rental on either side of the street and at least 150 feet away from such a property in any direction.
- Cayucos. Must be at least 100 feet away from another existing vacation rental on either side of the street and at least 50 feet away from such a property in any direction.

In all cases, the owner is limited to no more than four rentals within a given month. The owner is not permitted to place any exterior signage that identifies the property as a vacation rental.

### ***Relevant Fees and Taxes***

As mentioned earlier, a licensed vacation rental contributes to county revenues in several ways. In addition to obtaining an initial business license fee of \$41 (\$33 for each year's renewal), the owner of a rental must collect the following for each night's billed rate:

- State sales tax of 7.5%. Of this, 1% is returned to the county<sup>5</sup>. The state collects this tax.
- Transient occupancy tax of 9% in unincorporated areas of the county<sup>6</sup>. The transient occupancy tax is a tax on the guest and is held in trust by the property manager or owner before being turned over to the county.
- Tourist business improvement district assessment fees which vary by jurisdiction. For those unincorporated areas of the county with a tourist business improvement district, the assessment fee is 2% which is shared between the county and the community and used to promote tourism. The county collects this fee from the property manager or owner.

## **CONCERNS ABOUT NOISE AND PARKING**

Some residents believe the presence of vacation rentals and their transient population may increase parking concerns and noise. For example, a large group may rent a residence and then arrive with multiple cars that occupy off-site parking not allowed for vacation rentals, or a

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<sup>4</sup> The distance requirements apply not only to other existing vacation rentals but also to other types of visitor-serving accommodations such as a bed and breakfast. The ordinances provide additional details on how these measurements are determined.

<sup>5</sup> 6.5% is retained by the state; 0.75% is returned to the local jurisdiction which would be the county in non-incorporated areas and the remaining 0.25% is returned to the local transportation fund for the county.

<sup>6</sup> Both transient occupancy tax and tourist business improvement district assessment fees can differ in the

incorporated cities of the county.

celebrating vacation group may host a party and generate a high level of noise. Repeated rentals have the potential to create an ongoing noise or parking problem.

### ***Requirements and Complaint Process***

As amended in 2013, the vacation rental ordinance requires all parking for a vacation rental to be entirely on-site.<sup>7</sup> It further requires all vacation rentals to comply with current noise standards. It defines this complaint escalation process:

1. Every vacation rental must identify a local contact property manager (either the owner or a professional property manager), post the contact information for the manager inside the unit and provide the contact information to the Sheriff. Because this information is posted inside, a neighbor with a complaint has no practical way to obtain the property manager contact information and therefore no way to complain to that person. When a property is first licensed as a vacation rental, the property manager notifies owners of neighboring properties but nothing requires this step ever be repeated unless the property manager changes.<sup>8</sup>
2. A complaint can be made to the Sheriff's Department. As required by the ordinance, the county maintains an online listing of the contact for every licensed vacation rental and the Sheriff's dispatcher has access to this information. In practice, the Sheriff's Department only contacts local property managers or county code enforcement when there are patterns of repeated issues. In all cases, the Sheriff's Department will dispatch a person to respond to noise complaints. While the response may not be immediate, the Sheriff's Department says such calls are normally responded to within one hour. A written report is made only if an arrest occurred or citation issued. The dispatcher forwards all parking complaints to the California Highway Patrol since they have jurisdiction over parking in county areas.
3. Finally, a complaint can be made directly to county code enforcement staff during normal business hours. In reality, the county gives precedence to complaints that involve health and safety leaving limited staff time to investigate vacation rental complaints. In addition, complaints about parking and noise are most likely to occur during evening and weekend

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<sup>7</sup> *Coastal Land Use Ordinance 23.08.165i*: "tenants of residential vacation rentals shall not use on-street parking at any time."

<sup>8</sup> *Coastal Land Use Ordinance 23.08.165k(1)*

hours when the office is not staffed and cannot respond. In fiscal year 2013-2014, county code enforcement handled only seven cases dealing with vacation rentals. This included both rentals without permits and those out of compliance with standards and conditions.

### ***Number of Complaints***

Members of advisory councils relayed anecdotal evidence that suggests vacation rentals do generate parking and noise issues, but the Grand Jury examined three years of county records regarding noise and parking complaints and found the actual number of complaints was under 20 for each of the past three years. Possibly, residents do not report such concerns because they believe they will be ignored. Also, residents might report concerns to the local contact but not to officials, although the Grand Jury interview with a property manager suggested such complaints were uncommon.

## **CONCERNS ABOUT THE LICENSING STATUS OF VACATION RENTALS**

Many interviewees expressed concerns that there are a significant number of unlicensed vacation rentals. Such rentals do not pay required taxes and fees, and potentially contribute to undesired changes in a neighborhood's quality of life while encouraging others to rent their houses illegally. Many interviewees also expressed concerns that some owners obtain vacation rental licenses to prevent any immediately adjacent property from being used as a vacation rental. After obtaining a license, these owners never rent the property. Such behavior could negatively impact the property owner who wants to run an active licensed vacation rental and potentially decrease tax revenue to the county by limiting the number of active rentals beyond the ordinance's intent.

### ***Estimating Unlicensed Rentals***

No accurate way exists to determine the number of unlicensed rentals. When the Grand Jury interviewed county and local officials, advisory board members and local residents, all believed that there are a significant number of unlicensed rentals. When offered, estimates ranged from between 20 and 50% of the overall number of licensed rentals. This suggests the potential for as many as 170 to 425 unlicensed units. When the Grand Jury compared a partial set of online and printed listings for vacation rentals for the Cambria area against the county's list of licensed rentals, it identified at least 25 that appeared to be unlicensed.

The vacation rental ordinance requires any vacation rental advertisement to include its transient occupancy tax license number.<sup>9</sup> However, the Grand Jury found no listings or advertisements that actually included this number. The county takes no proactive steps to enforce the requirement nor does it take any action to identify unlicensed vacation rentals.<sup>10</sup> At best, the county's approach to unlicensed vacation rentals can be described as complaint-driven, at worst, as benign neglect.

Only if a local resident complains will the county investigate; however, there is no easy way for neighbors to know if a vacation rental is unlicensed and should be reported. The Grand Jury found significant agreement among those interviewed that few residents understand how the ordinance operates or what they need to do if they have concerns. Unless the county's approach changes and becomes more proactive, a more accurate and detailed accounting toward control of unlicensed rentals will remain elusive.

### ***Financial Implications***

The failure of owners to register their property as licensed vacation rentals reduces the amount of taxes and fees collected. To illustrate the potential loss of revenue by an unlicensed rental, consider a vacation rental that rents for \$200 a night and is rented an average of eight nights a month. (This is a low estimate of revenue lost as preferred rentals on the ocean or with ocean views would normally charge more and have higher occupancy rates.) This rental would generate income of \$1600 a month or \$19,200 annually. If registered, the following fees and taxes would flow to the county:

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<sup>9</sup> This requirement is found in the *Coastal Land Use Ordinance, 23.08.165(l)*

<sup>10</sup> If a complaint is received, the county says it will verify that the vacation rental has a valid business license. If not, staff opens a case and pursues it until the relevant license is in place – or evidence of a vacation rental is deleted from all advertising sites.

Taxes and Fees

\$ 33	Annual business license renewal <sup>11</sup>
192	States sales tax at 7.5% would collect \$1440; \$192 of this is returned to the county
1728	County transient occupancy tax at 9%
384	Tourism business improvement district assessment at 2%
<b>\$2337</b>	<b><i>TOTAL of local taxes and fees for one unit for one year</i></b>

Using the rough estimate of as many as 425 unlicensed rentals, the potential annual loss in fees and taxes (using the example just given as an average) could be up to one million dollars.<sup>12</sup> In addition, other areas of the unincorporated county likely have unlicensed vacation rentals that increases this potential number. Even a portion of this income could cover county costs of staff to enforce the code.

***Enforcement Possibilities***

Relatively modest steps could be taken to identify unlicensed vacation rentals. For example, a county code enforcement staff member—or a clerk using a prepared form letter—could audit vacation rental agencies by requesting the transient occupancy tax license number for each unit it advertises. The county could match addresses of licensed vacation rentals with advertised vacation rentals to see which are legal. In addition, the county could, on a random basis, directly follow up with owners using online listings such as VRBO.com, Airbnb or HomeAway.com. Examples exist of other government agencies doing audits of similar requirements. For example, a recent effort began in Morro Bay to verify business licenses for all businesses within that city. The county itself conducts a small random audit of licensed hotels and vacation rentals to ensure compliance with transient occupancy tax collection.

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<sup>11</sup> Business license fees are intended only as a cost recovery measure and not a major source of revenue.

<sup>12</sup> An additional countywide tourism business improvement district is under consideration which would increase this number.

### ***Unused Licensed Vacation Rentals***

The county does know the number of licensed vacation rentals that generate no rental revenue. In 2013, of the 667 rentals in Cambria, Cayucos and Avila Beach, 250 (or 37%) of them generated no transient occupancy tax. An additional 67 generated less than \$500 annually. Many reasons might explain why a property was not rented for an entire year: it may be a less desirable property that generates little interest; the owners may be using the property themselves for the majority of the year or special conditions might prompt the owner to remove the unit temporarily from the rental market. However, a vacation rental license continues indefinitely (as long as the business license is renewed) whether or not the property is rented. As a result, an unused license has the effect of locking out nearby properties from obtaining licenses. At least one advisory council recommended that unused licenses have a termination date or conditions set for renewal.

## **MINOR USE PERMITS**

### ***Definition***

Owners seeking a vacation rental license who cannot obtain a zoning clearance can apply for a minor use permit. If granted, the minor use permit allows an exemption from the ordinances for that particular property. By design, minor use permits are intended to provide the county with the flexibility to override an ordinance based on special factors.

### ***The Minor Use Permit Process***

The application for a minor use permit is submitted to the county's Planning and Building Department (Planning Department). The Planning Department is responsible for applying the county code to specific situations and acting on requests for licenses. Once the Planning Department makes a decision on a request, an appeal can be made. Minor use permits expire 24 months after the issue date if not used.

### ***Minor Use Permits and Vacation Rental Licenses***

Since 2012, there have been two minor use permits issued for Cayucos properties, none within Cambria and two just outside Cambria. The situation is different in Avila Beach where 12 minor use permits have been issued since 2012, and five were issued in 2014. No minor use permit has been denied in any of these areas for vacation rental units.

## **CONCLUSIONS**

San Luis Obispo County abounds with areas popular with tourists. As a result, many property owners list their units as vacation rentals. To ensure that such rentals are both licensed and fit in with the overall quality of life in their respective neighborhoods, the Board enacted ordinances to regulate vacation rentals and to set taxes and fees associated with their operation. However, many aspects of those ordinances are not being effectively enforced. Still other elements of the ordinances could be improved with simple adjustments. In addition, because the county does not ensure vacation rentals are licensed, it is losing tax revenue. Such revenues are likely sufficient to pay not only for enforcement activities but also generate additional revenue for the county general fund.

There is also a question of fairness. Current practices allow some owners to avoid following regulations, while others fully follow the law. Lax enforcement encourages more people to ignore the code. Given the importance of tourism to the county's economy, the Grand Jury believes better oversight of vacation rentals is a goal the county should pursue.

## **FINDINGS**

F1. The county has adopted and subsequently updated a vacation rental ordinance in Avila Beach, Cambria and Cayucos intended to maintain community quality of life and ensure consistency in vacation rental policy.

F2. The number of licensed vacation rentals in these areas of the county is growing.

F3. Many residents are unaware of the provisions of the ordinance dealing with the licensing and management of vacation rentals.

F4. The county has placed a low priority on enforcing provisions of the ordinance dealing with the licensing and management of vacation rentals.

F5. While the county has a process to respond to parking and noise issues connected with vacation rentals when they are brought to the attention of the Sheriff, California Highway Patrol or Planning Department, residents have no effective way to identify the property manager who is supposed to be the first level of contact for such complaints.

F6. The county has no proactive programs to identify unlicensed vacation rentals even though officials believe the number may be significant.

F7. Although the county can identify those homeowners whose transient occupancy tax certificate generates little or no revenue, the county has no policy that limits the renewal of such certificates and associated business licenses.

F8. There is no termination process for inactive or unused vacation rental licenses.

F9. The county loses revenue when property owners or managers operate unlicensed vacation rentals and do not pay relevant taxes and fees.

F10. The county loses revenue when individuals obtain transient occupancy tax certificates and then do not use them since this effectively blocks others from obtaining such certificates and using them.

F11. Increased enforcement of vacation rental license compliance and associated tax and fee revenue collection would generate funds to cover the costs of such activity.

F12. The Planning Department and the Office of the Auditor, Controller, Treasurer and Tax Collector (Tax Collector) do not coordinate with one another on issues of unlicensed vacation rentals or with licensed vacation rentals which pay little or no transient occupancy taxes.

## RECOMMENDATIONS

R1. The Board of Supervisors should provide direction and funding to place higher priority on enforcing coastal vacation rental regulations.

R2. To better support the complaint process, the county should implement a way for residents to identify the appropriate property manager for a vacation rental. This could be to require an annual notification to neighbors by the property manager or having the county maintain a public online listing of vacation rental contacts.

R3. The Tax Collector should set a minimum level of revenue to be generated over a set time period (e.g., 2 to 3 years) in order to retain a transient occupancy tax certificate.

R4. The Tax Collector and the Planning Department should develop and implement a process to deal with the issues of unlicensed vacation rentals and unused or minimally used transient occupancy tax certificates.

R5. The Planning Department should enforce the requirement to list transient occupancy tax certificate numbers on advertised vacation rental listings.

R6. The Planning Department should create and post on its website a list of licensed vacation rentals by address so concerned individuals can confirm whether a given property is a licensed vacation rental.

R7. The Planning Department should determine and fund a way to monitor whether advertised vacation rentals are properly licensed, thus ensuring collection of related taxes and fees, which can more than cover these costs.

## REQUIRED RESPONSES

The San Luis Obispo County Board of Supervisors is required to respond to Findings 1-12 and Recommendations 1-7.

The San Luis Obispo County Department of Planning and Building is required to respond to Findings 1-3, 5-6, and 11; and Recommendations 2 and 4-7.

The San Luis Obispo County Office of the Auditor, Controller, Treasurer and Tax Collector is required to respond to Findings 6-12 and Recommendations 3 and 4.

The responses shall be submitted to the presiding judge of the San Luis Obispo County Superior Court. Please provide a paper copy and an electronic version of all responses to the Grand Jury.

Presiding Judge	Grand Jury
Presiding Judge Dodie Harman Superior Court of California 1035 Palm Street, Room 355 San Luis Obispo, CA 93408-1000	San Luis Obispo County Grand Jury P.O. Box 4910 San Luis Obispo, CA 93403-4910 GrandJury@co.slo.ca.us