

Barely hanging on.



**A Submission to the
N.Y.C. Rent Guidelines Board
Relative to Order No.25**

Rent Stabilization Association
John J. Gilbert, President
Jack Freund, Director of Research
May 4, 1993

Table of Contents

Introduction	3
RGB Increases Have Been Inadequate	5
Operating Ratios Rise	5
Costs Excluded	6
Uncompensated Past Losses	7
Housing Affordability	8
The Mandate of th RGB	8
Housing Remains Affordable	8
What to Do About Housing Affordability	10
The Condition of the Housing industry	11
Squeeze on Operating Margins	11
Depressed Rents and Rent Collections	12
Tax Delinquencies	13
Housing Conditions	13
Break-Even Rents	14
Financing and Foreclosure	14
Recommended RGB Actions	16
Raising Low Rents	16
Renewal Guidelines	17
Vacancy Allowance	17
Special Guideline	19
Water and Sewer Changes	19

Introduction

The Rental Housing Crisis

This year the Rent Guidelines Board must confront and address the inescapable conclusion that New York's rental housing is mired in a deep and growing state of crisis. This state of crisis was most recently recognized in a March, 1993 report by the Community Service Society (CSS) entitled "Housing on the Block", which examined leading indicators of housing abandonment including real estate tax delinquency, receivership and foreclosure actions and arson. Based on these indicators, the CSS report estimated that 140,000 rental housing units are in imminent danger of being lost from the private sector.

CSS is not alone in ringing the alarm bells. In 1992, the Citizens Housing and Planning Council released a report which estimated that 50,000 housing units were at risk of abandonment due to steadily spiraling costs of real estate taxes and water and sewer charges.

Going further back, in 1989, the RSA analyzed the location and nature of rental properties acquired by the City through tax foreclosure and

concluded that there were 100,000 similarly situated housing units in danger of abandonment.

The current rise in tax delinquencies and foreclosures, the weakness in the housing market, the unavailability of financing and other factors constitute a clear and imminent danger to New York's housing industry. It is too late to save all the housing now at risk. But by acting now, the Rent Guidelines Board can contain the danger.

The Role Of the RGB

The RGB has a broad legal mandate to preserve the health of the housing industry. To accomplish its goal, it has a narrow set of tools available which consist of the authority to authorize rent increases.

Low rents and inadequate rent increases are not the only problem plaguing the housing industry. Besides rent regulation, the industry simply suffers from too much regulation of every variety, with owners subject to regulation by more than two dozen City and State agencies. These interacting systems of regulation have dramatic cost consequences, as

well as a debilitating effect on the spirit of the industry.

The RGB cannot address all the problems facing the housing industry with the limited tools available. However, to the extent that the past practices and actions of the RGB have contributed to the current state of crisis the RGB is now obligated to do all within its power to remedy the current situation.

During the period of stabilization, the RGB failed to provide rent increases sufficient to meet the costs of operating and financing rental housing. The evidence from the income and expense records filed with the Department of Finance is clear on this score. By one measure, the ratio of operating costs to rents has soared from 55% in 1971 to 76% in 1991. By any measure, the economic condition of rental housing has deteriorated, and the RGB is charged with preventing such deterioration.

During the period of stabilization, the RGB has held sitting tenants largely harmless from the increased costs of operation and has thereby created vast divergences in rent between similar apartments in the

same building. Simultaneously, many rents have been held below the required costs of operation and financing, with half of all stabilized apartments renting for less than \$450 per month, a number which approximates the average cost of operating and refinancing rental property.

During the last three years, the pattern of inadequate increases has continued, to aggravate the problem. The RGB failed to adequately compensate owners in 1990 when costs increased by 11% and rents were raised by just over 4% and failed to make up for that deficit in the next two years when operating costs rose more moderately. This year, with a moderate increase in operating costs, the RGB has an opportunity to compensate owners at least partially for the deficit developed at the hand of the RGB during the years of rent stabilization.

Housing Survival in the 1990's

With the looming crisis in the housing industry, the RGB cannot and need not be overly solicitous of the concerns of tenant advocates and the demand for low rent increases. RGB staff reports have clearly indicated that the economic condition of tenants has re-

mained static over the past decade and that, in fact, rent stabilized tenants now have more disposable income than they had ten years ago. While the economic position of tenants has been maintained or improved, the economic plight of rental owners has steadily worsened.

No one would argue that the RGB can cure all the problems now afflicting the rental housing industry, but the RGB can have substantial remedial effects. The RGB can begin to restore net operating income by providing one and two year rent guidelines substantially higher than the traditional commensurate adjustment, and it can begin to implement a commensurate rent adjustment methodology based on inflation adjusted net operating income.

The RGB can ensure that each rental apartment at least carries its fair share of operating and financing costs by endorsing the concept of break-even rents and providing low rent supplements and long term occupancy adjustments to ensure break-even rents. The RGB can help owners restore profitability upon a vacancy by providing a substantially higher vacancy allowance than in the recent past, or by imple-

menting a concept of highest comparable rent upon vacancy. The RGB can also endorse the concept of free market dynamics and help restore profitability by setting a reasonable guideline for decontrolled apartments entering stabilization.

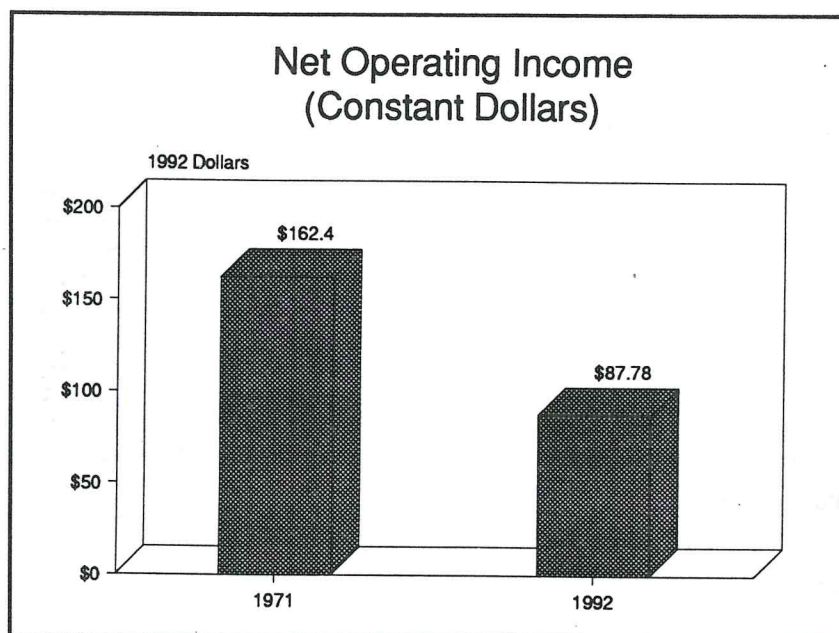
In short, the RGB has a whole host of measures at its disposal to help restore profitability to the rental housing industry and help the industry meet the challenges of the 1990's. The RGB only needs the conviction that it can and must make a difference.

RGB Increases Have Been Inadequate

By conscious design and intent, the RGB has, over the years, followed a pattern and practice which has resulted in inadequate rent increases which have failed to keep owners whole. The resulting squeeze on the bottomline of rental property has become so severe that the RGB can no longer avoid addressing the issue. The methodological underpinning of RGB practice can and must be modified to prevent continued deterioration of the economic condition of the industry.

Operating Ratios Rise

Even before Department of Finance income and expense information became available to the RGB, it was evident that the economics of rental housing were deteriorating under the increases set by the RGB. The traditional method of tracking the effects of RGB guidelines (Table 14 of the Explanatory Statements, last known as Table 9) clearly shows that the operating cost to rent ratio has steadily increased during the period of stabilization from 55% in 1971 to 73% in 1992. As a result, net operating income, the dollars available to finance debt



service, reserves for losses, capital improvements and profit, has steadily declined.

As a basis of comparison it should be noted that the operating cost to rent ratio on a national average remains below 50% with no indication of a consistent rise over time, according to a recent survey by the Institute of Real Estate Management, while the current ratio for stabilized property in New York is 76% and rising.

The primary reason for the rise in the operating ratio in New York is the commensurate rent adjustment methodology used by the RGB. Under this methodology the Board bases its rent increases on a percentage of the increase in

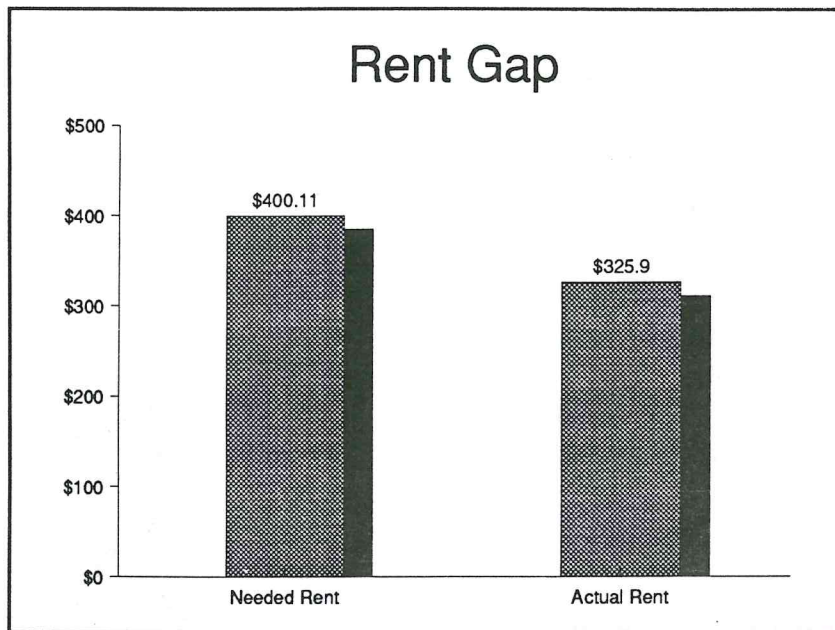
operating costs determined by applying the prior operating ratio (if operating costs increased by 4% and the operating cost ratio were 75%, then the commensurate rent increase would be 3%). The RGB has only rarely attempted to adjust net operating income for the effects of inflation.

As elaborated in the Explanatory Statement in 1980, the Board acknowledged that the practice of compensating owners only for increases in operating costs would maintain the same net operating income while allowing the operating cost ratio to rise. In effect, the Board was saying that if an owner had a net operating income of 45 cents on the dollar

in 1971, the RGB's goal was only to ensure that the owner's net operating income in 1992 was 45 cents on the dollar, despite the fact that 45 cents in 1992 dollars was worth far less than 45 cents in 1971 dollars. The charts on this and the preceding page indicate the extent, in constant dollars, to which net operating income has fallen, and the amount of rent increase necessary to restore net operating income to its 1971 level.

The income and expense data obtained from the Department have only served as confirmation of the deteriorating economic condition of rental housing in New York. Four years ago, the operating cost to rent ratio was determined to be 72%. In the current analysis, that ratio has risen to nearly 76%.

The RGB staff has taken to "adjusting" these ratios in order to minimize the shocking impact of the numbers. Even on an adjusted basis, the RGB staff numbers show operating cost to rent ratios increasing from 60% to 63% over four years, at the same time that operating ratios on a national level are going down. The Board should be aware that the staff adjustments to the income



and expense numbers have been extremely lopsided.

In adjusting the income and expense data, RGB staff has relied on the result of audits of a small sample of income and expense statements conducted by Department of Finance. Apparently, the audit results led to the conclusion that expenses were overstated by an average of 8%. It is noteworthy that, at the time, the Department of Finance did not conclude that the disallowed expenses were not actual expenditures, only that the disallowed costs were not eligible expenditures in terms of the criteria of the Finance income and expense statements.

Costs Excluded

The basis for adjusting expenses downward is important

because many legitimate expenditures are not permitted to be reported on the income and expense statements. For instance, major capital improvement expenses, whether they be for refrigerator replacements or building systems replacements, cannot be entered as expenses. Nevertheless, income derived from such expenses is included in the income side of the equation.

In short, the operating cost to rent ratio derived from Finance's income and expense statement is understated to the extent it includes income without the attributable expense items. The ratio is then further understated by the practice of further "adjusting" the expense side of the equation.

Uncompensated Past Losses

More recently, the RGB has adopted another rationale for keeping rent increases below required levels: "the need for rent increases to take a more stable course of adjustment than the short term movements of operating costs evidenced by the annual Price Index of Operating Costs." (Explanatory Statement, 1991).

This rationale may have made sense in 1990 when a relatively high Price Index of nearly 11% resulted in guidelines yielding rent increases of just over 4%. However, the rationale fell apart in 1991 when a relatively low Price Index of 6% yielded guidelines equal to a rent increase of just under

4% and in 1992 when a Price Index of 4% yielded a rent increase of just over 3%. If the RGB's "smoothing" rationale were operative, then the low 1991 Price Index would have provided an opportunity for compensatory rent increases.

Thus, the RGB has historically failed to use periods of low inflationary pressures as an opportunity to compensate owners for periods in which rent increases did not keep pace with high increases in operating costs.

Today's current guideline period, with its relatively low increase in operating costs, provides another opportunity for the RGB to compensate owners for the deficient practices and patterns of the past.

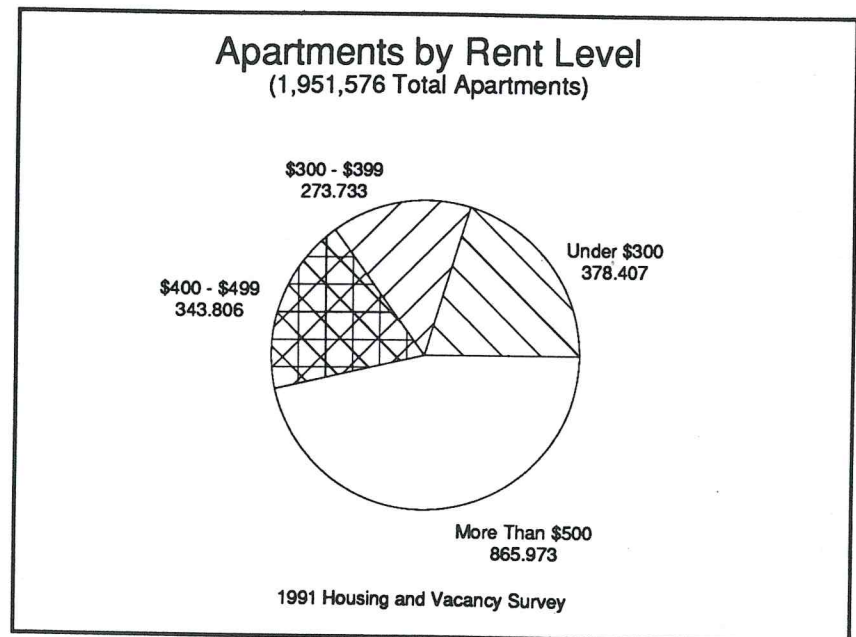
Housing Affordability

Housing affordability is consistently raised as one of the two components which the RGB must weight and balance in its quest for fair and equitable rent guidelines. However, the matter of affordability is not straight forward and raises a number of issues: first, to what degree, if any, should the RGB take affordability issues into consideration; second, to the extent the issue is considered, what facts should be placed on the balance scale; and finally, what is the RGB to do based on the facts under consideration.

A review of these issues, especially this year, indicates that housing affordability need not be a major source of concern for the Board. Rather, the Board may take solace in the fact that rent guidelines over the years have more than adequately protected the economic interests of tenants and that current market conditions now afford tenants even more protection.

The Mandate of the RGB

The legislative mandate of the RGB is quite clear: the RGB is to take under consideration the economic condition of the



housing industry and to enact guidelines which will maintain the health of the industry as a competitive investment. While the legislation authorized the Board to consider other factors, the matter of tenant affordability is neither explicitly mentioned nor present in the enabling legislation.

We do not believe that the legislature's omission of any reference to tenant affordability was an oversight. Rather, it seems apparent that the RGB's action of setting just those guidelines which are reasonable and necessary to maintain rental housing constitutes the tenant protections which the legislature intended when it es-

tablished the rent stabilization system.

Housing Remains Affordable

To the extent that the Board does look at the issue of housing affordability, it finds that housing has actually become more affordable for the average stabilized renter. Data provided by RGB staff based on the 1991 HVS demonstrated that the percentage of income spent on rent has remained essentially unchanged over the past decade for rent stabilized renters in New York City. At just under 26%, the median rent to income ratio remains well below the 30% Federal standard. The position of New York City renters stands in

stark contrast to that of renters in the nation as a whole, where rent to income ratios have increased steadily over the decade.

Even more striking is the fact that, in at least one important sense, the economic condition of stabilized renters has improved over the decade. According to RGB staff analysis (see table reproduced on this page) stabilized renters actually have more disposable income in 1991 than they had in 1981.

The improved condition of renters in New York, in contrast to other localities, is easily explained in terms of the RGB having done too good a job of keeping rents low. In fact, people are often surprised at how low rents in New York are. The chart on the preceding page illustrates that of all apartments in New York, a majority rent for less than \$500 per month, with more than 20% still renting for less than \$300. Even when we look just at stabilized apartments, half of those apartments rent for less than \$480 per month, with

13%, or 121,069 of apartments renting for less than \$300 per month and 31%, or 289,438 apartments renting for less than \$400 per month.

For a sense of perspective, compare the 1990 median rent of \$448 per month in New York City with the median rent in other comparable large cit-

While reflecting the effects of 24 years of rent guidelines, the 1991 HVS does not yet capture the even more fundamental effects of market forces on housing affordability. Simply put, a weak housing market is forcing rents down throughout the five boroughs, providing tenants with their best protection against excessive rents: a competitive housing market.

Despite this almost glowing picture of the economic condition of renters, there are those who will point to the large numbers of tenants paying disproportionately high amounts of their income for rent as a basis for not providing the rent increases which are required. While no one would deny that there are poor people living

in New York, the income data provided by sources such as the HVS must be viewed with some suspicion.

It is noteworthy that, because of the large number of cases in which tenants do not report income, the City had contracted with the Census Bureau for a separate analysis of the 1991 HVS which would

**Change in Income and Annual Rent
(constant 1990 dollars),
Rent Stabilized Households,
1981 - 1991**

	Median	Mean	Middle Quintile
Income			
81	\$20,200	\$26,900	\$20,100
91	<u>\$21,400</u> + 1200	<u>\$28,900</u> + 2000	<u>\$21,600</u> + 1500
Rent			
81	\$5100	\$5900	\$5200
91	<u>\$5600</u> + 500	<u>\$6400</u> + 500	<u>\$6000</u> + 800
Income Available for Non-Housing Expenses			
81	\$15,100	\$21,000	\$14,900
91	<u>\$15,800</u> +700	<u>\$22,500</u> + 1500	<u>\$15,600</u> + 700

Source: RGB Staff, 1993

ies: Boston, \$546; Los Angeles, \$544; San Diego, \$560; San Francisco, \$613. Thus, the perception of New York City as a high rent town does not hold up in absolute or relative terms and is likely a consequence of forgetting that New York City exists beyond the boundaries of Manhattan.

impute incomes in these cases, much as the Census Bureau does with other of its surveys. That additional analysis has not been carried out.

As result, the HVS data contains many instances where tenants report paying rent which is greater than their income, or report paying such high percentages of income for rent that these situations simply cannot be as reported over a period of time. For instance, 8% of all renters in the 1991 HVS report paying gross rent in excess of income. And 18% report paying more than 90% of income for rent. While these situations simply cannot be real, they distort the image of the true economic condition of renters.

What To Do About Housing Affordability

While it is clear from the above that affordability is not a serious consideration for the Board, especially this year, there is still an open issue as to what the Board would do should this issue be considered a source of serious concern.

Let's imagine a worst case scenario in which it was determined that a significant percentage of New York tenants could not afford any rent increase whatsoever, and would not be able to afford an in-

crease in the foreseeable future without income support, which was not forthcoming. At the same time, building operating costs were rising inexorably, largely as a result of the imposition of government assessments and charges. Meanwhile the bulk of tenants were paying affordable rents, their incomes were secure and rising and a smaller percentage of tenants were generating substantial incomes and living at bargain rents.

Under these circumstances, the quandary before the RGB would be whether to abstain from granting the required rent increases in order to hold harmless those tenants unable to pay any rent increase whatsoever, and thereby risk losing the housing stock they occupy to continued deterioration and eventual abandonment.

We would suggest that it is the responsibility of government, and not that of the Rent Guidelines Board or of private owners to provide for those who cannot afford an economic rent. There are already more than half a million units of subsidized housing in New York City; more subsidized units than poverty level households.

City government has clearly acknowledged its responsibil-

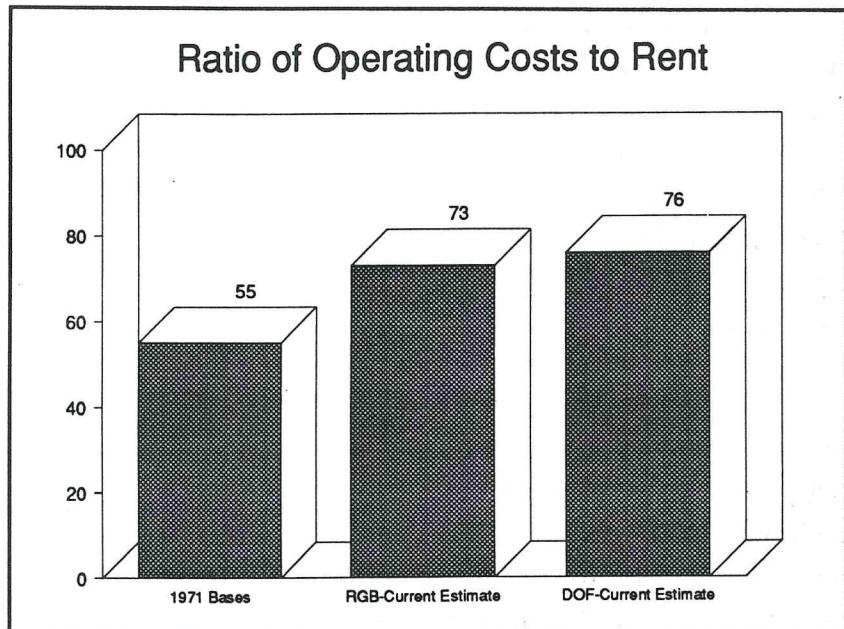
ity for low income households: by maintaining an ongoing ten year capital program of housing rehabilitation and construction, by providing more public housing than any other City in the nation, by providing rent subsidies for the elderly and poor in private housing and by a host of other measures which make New York's housing market the most heavily subsidized market in the nation. The acknowledgment by government of its responsibility for the poor should permit the RGB to deal with the average renter who is doing better than renters nationwide, and the average owner who is doing far worse than owners nationwide.

The Condition of the Housing Industry

Rental properties are not abandoned overnight. The process of deterioration and disinvestment is a long and sometimes subtle one. Initially, as building income falls below the cost of operation and finance, operating margins are squeezed and a building becomes an unlikely prospect for additional capital investment. Subsequently, expenditures on building operating costs are reduced and building conditions begin to deteriorate. In the final stages, funds are no longer available to pay property taxes and/or mortgage payments and the building becomes subject to foreclosure by a private lender or the City.

All these indicators of the abandonment process are abundantly evident in today's rental housing market. Operating margins have risen dramatically and are at extraordinarily high levels. Building conditions, after a period of improvement, have again begun to deteriorate. Tax delinquencies and foreclosures are at record high levels. All the indicators of crisis are in plain evidence.

These indicators of abandonment cannot be attributed



to the general economic decline in the City and nation. They are a unique result of factors directly under the control of City and State government. Costs imposed on building owners by government have soared far higher than the general pace of inflation. Rent increases allowed to property owners have failed to keep pace with these costs. Government has failed to increase income supplements for our poorest renters to keep pace with the increase in housing costs.

Because the dire conditions in the rental housing market today are, by and large, a result of 50 years of governmental

intervention in the private sector housing market, the RGB is now obligated to do all it can to restore health to that market.

Squeeze on Operating Margins

We have already indicated that the RGB's reliance on the commensurate rent adjustment methodology has resulted in reduced operating margins. This occurs because only operating and maintenance costs are adjusted to account for inflationary pressures, while net operating income is held constant.

To gauge the effects of this methodology, let us consider what happens to the allowance

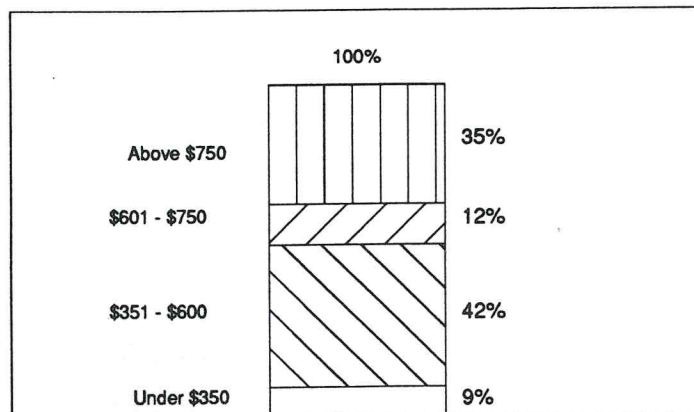
for vacancy and collection losses, which is one of the building costs paid out from net operating income. For simplicity, let us assume a 1971 apartment rent of \$100 and a vacancy and collection loss of 5%. Thus, in 1971, for every \$100 of rent, \$5 in net operating income would be set aside for vacancy and collection losses.

If we assume that the 1971 rent of \$100 had increased to \$300 by 1993, the vacancy and collection allowance required would have risen to \$15, assuming the same 5% allowance. However, since the RGB has only adjusted operating costs upward and not net operating income, the owner would only have \$5 set aside to cover a \$15 vacancy and collection loss in 1993.

The same analysis can be applied to the cost of financing which has increased dramatically during the period of stabilization, (notwithstanding the recent declines in interest rates), the costs of non-reimbursed capital improvements, and profit.

As a result of the failure to adjust net operating income for the effects of inflation, a gap had developed between current rents and rents actually needed to operate and finance rental

Reduced Rents (13% of all units)



property. We calculate that rent gap to be nearly 23%.

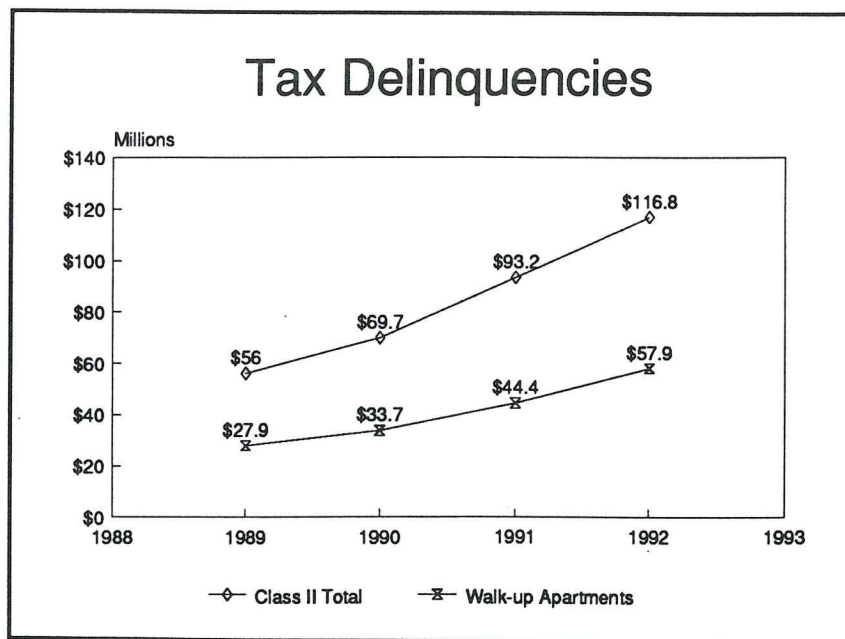
Depressed Rents and Rent Collections

The rent gap discussed above assumes that owners are collecting the rents they are legally entitled to collect. However, we know that vacancy and collection losses have increased dramatically and currently constitute one of the major problems of the rental housing industry.

Analysis by the RGB staff indicates that vacancy and collection losses increased from 10% to 15% of rents in the latest reporting period. This is roughly double the vacancy and rent loss reported on a national level by the Institute of Real Estate Management.

To shed further light on this issue of rent loss, we examined preferential rents listed in RSA's annual rent registration data to compare the prevalence and distribution of such rents in 1991 and 1992. We found that preferential rents increased significantly from 9% of all units in 1991 to 13% of all units in 1992. The distribution of these units by rent level is indicated in the chart above and reflects the fact that a majority of the reduced rents are not in "luxury" rentals but are found in apartments renting for less than \$750 per month.

Reduced rents and vacancy and collection losses are significant from the perspective of the RGB in two ways. First, they indicate that market conditions often offer more effec-



tive limitations on the level of rents than guidelines issued by the RGB. Second, they indicate that property owners are not benefiting from rent increases established by the RGB to the extent anticipated.

In light of the market limitations on the collection of legal rents and the substantial problem of vacancy and collection losses, we would argue that the RGB needs to adjust its sights. If, for example, the RGB were to determine that a 5% increase is required to keep owners whole, it would have to authorize an increase of 5 3/4%, or a 15% higher increase than required, to meet its 5% target.

Tax Delinquencies

Perhaps nowhere is the distress in the rental market more evi-

dent than in the growing trend of tax delinquencies. Withholding of real estate taxes and water and sewer charges are traditionally viewed as one of the later stages of disinvestment and abandonment. Owners are reluctant to withhold tax payments not only because of the threat of municipal foreclosure but also because the interest penalties for late payment are so onerous. Thus, tax delinquencies generally occur only after operating margins have disappeared and maintenance expenditures have been pared to a minimum.

These danger signals are why the upwards spiral in real estate tax delinquencies is so threatening. As indicated in the chart on this page, delinquencies for all Class II residential

properties have more than doubled from \$56 million in 1989 to \$116.8 million in 1992. Smaller walk-up apartment buildings account for approximately half of all tax delinquencies in Class II.

At the same time, the number of properties subject to in rem vesting actions by the City have more than tripled in the last four years, rising to a record level of more than 17,000 properties in 1992.

Despite the real estate tax rate freeze currently in effect and the drop in overall tax assessments forecast for the upcoming fiscal year, the pressures of increasing taxes have not been eliminated particularly in the City's poorest neighborhoods. As the chart on the next page indicates, the City's poorest neighborhoods have suffered disproportionately high increases in taxes. This trend has continued, as reflected in this year's PIOC with taxes in the City's poorest neighborhoods increasing at a rate three times higher than the city wide average.

Housing Conditions

Another indicator of eventual abandonment, building maintenance conditions, have once again continued their downward trend. As indicated in the RGB staff analysis of the HVS

data, building maintenance indicators, after improving substantially between 1981 and 1987, have apparently given up almost all of those gains between 1987 and 1991.

We take the decline in building condition indicators as a reflection of the fact that owners have had to reduce maintenance expenditures as rent increases have failed to keep pace with cost increases, as increasingly older buildings require more and more repairs and capital investments and as vacancy and collection losses have grown.

Break-Even Rents

Nowhere are the problems of the housing market better represented than in the smaller, low rent buildings which are the backbone of many of the

City's neighborhoods. As indicated in RGB staff report, smaller buildings have consistently lower rents than larger buildings. On the other hand, operating costs for smaller buildings are higher than for the next larger category of buildings. It would appear, although the numbers are not directly derivable from staff provided data, that these smaller buildings on average exhibit operating ratios substantially higher than average, in the range of 82% to 90%.

Given such high operating ratios, it is no wonder that the buildings exhibiting operating to rent ratios in excess of 100% are mainly older, smaller buildings with low rents and high operating costs. It is also no coincidence that the smaller

low-rent buildings are predominantly the buildings seized by the City for lack of tax payments.

Buildings with rents below operating and financing costs cannot long remain in business. Many such buildings are subsidized by their owners, for whom the building is often home. Some of these buildings are subsidized by commercial rents, but with the pressures on the commercial market, this source of income is also drying up. The surest way to maintain the 13% of buildings which are in economic distress is to raise their rents to the minimum level required to meet operating and financing costs, to a break-even rent.

Financing and Foreclosures

There has been considerable discussion about the extent to which the crisis in the rental market today is a result of over-financing in the 1980's. While some buildings were undoubtedly over-leveraged in the heyday of co-op conversions, that does not constitute a significant portion of the problem today.

The RGB staff mortgage survey makes it clear that financial institutions continue to leave the rental finance market, and that those institutions still

Average Real Estate Tax Increases

Community District		1987-88	1988-89	1989-90	1990-91	Cumulative
City-Wide		8.10%	15.76%	12.05%	8.90%	52.69%
S.E. Bronx	1	6.87	31.03	20.43	18.02	99.03
	2	21.21	20.26	30.70	13.25	115.23
	3	12.01	17.62	39.55	24.12	128.19
Crown Hts., East NY	8	9.00	19.45	15.25	14.62	71.93
	9	6.51	24.28	13.27	10.39	65.50
West Harlem	9	15.1	25.99	13.27	00.74	65.47
Upper Eastside	8	10.5	14.02	11.60	9.76	54.32

Sources: Price Index of Operating Costs for Rent Stabilized Apartment Houses in New York City, for 1991, 1990, 1989, 1988.

in the business have adopted increasingly strict underwriting criteria. Even buildings which are perfectly profitable have difficulty obtaining mortgage financing in the current market.

The crisis in financing should come as no surprise in light of what we know about declining net operating income. As net operating income declines, less funds are available to finance debt service.

Recommended RGB Actions

This year the Rent Guidelines Board confronts both a growing crisis in the housing industry and a rare opportunity to help stave off disaster. The RGB must recognize that the today's housing industry is like a bus full of passengers heading towards a precipice. The RGB has the capability to steer that bus away from the precipice. And, perhaps ironically, the RGB can rely on existing market forces as part of the steering mechanism.

Raising Low Rents

The most important measure the RGB can take this year is to raise low rents to levels which can meet minimum building operating and financing costs. We have already seen that substantial numbers of rent stabilized apartments are at rents below "break-even" rents. Worse yet, these low rents are concentrated in certain buildings in specific low-income neighborhoods.

These buildings and neighborhoods are plagued by many problems in addition to those low rents. The buildings, on average, are more than 60 years old and in desperate need of major capital improvements,

municipal services and social support networks are often weak in these neighborhoods, increasing the burden on property owners to compensate for missing non-housing services. At the same time, a majority of the property owners in these neighborhoods are themselves immigrants, struggling to survive in a new environment, often holding down more than one job to make ends meet and keep their buildings alive.

For several years, the RGB recognized the legitimate and special needs of low rent apartments by adopting a supplementary allowance for low rent units. This allowance began as a \$10 supplement in addition to the guidelines for apartments renting for less than \$200 and had reached an additional \$15 for apartments renting for less than \$350 per month before it was eliminated.

The RGB had authorized the supplementary adjustment for a very simple reason: it recognized that apartment buildings could not be sustained with uneconomic rents and that a uniform percentage increase translated into a lower dollar amount for low rent units than

for high rent units. The low rent adjustment, therefore, was a consequence of economic reality as well as mathematical common sense.

When the low rent adjustment was eliminated in 1990, it was eliminated as a purely political act. There is no way to avoid the blunt conclusion that a newly appointed Board, selected by a newly elected Mayor, elected with strong backing by tenant advocates, reacted to the unprecedented, politically motivated, written plea by the Mayor to eliminate the supplementary adjustment for low rent apartments.

We are now witnesses to the results of the elimination of the low rent adjustment and the general indifference of this City administration to the plight of private housing providers. Municipal levies on the housing stock have continued to increase without commensurate increases in rent. Tax delinquencies and foreclosures have increased as a consequence.

Worst hit are the small, low rent buildings, which are the prime candidates for municipal foreclosure. Some have argued that the low rent adjustment

has served its purpose and is no longer necessary; rents in low rent apartments have increased enough, they argue.

However, the fundamental purpose of the low rent adjustment is just as valid now as it was when first enacted. The lowest rents on the scale will always suffer disproportionately as the result of an average rent increase applied across the board. This is so because it is still true today that a lower rent apartment will not see as great a dollar increase as a higher rent apartment when the same percentage increase is applied.

Assuming that the lowest rent apartments are operating at below break-even rents, these apartments will continue to lose ground as long as they are subject only to the same percentage increase required to keep an economic apartment even with operating costs. Therefore, it is absolutely essential that a low rent adjustment again be implemented to ensure that these apartments, now operating at non-economic rents, are allowed to at least reach break-even levels.

Renewal Guidelines

This year is also critical for the one- and two-year renewal lease guidelines established by

the Board. Under the traditional methodology used by the RGB, operating cost to rent ratios will continue to rise, without any sense that a critical boundary has been breached. As we have seen, the current methodology would allow the operating cost ratio to exceed 100% without any notion that this would be a disastrous situation.

This year the RGB must recognize that rising operating ratios have reached a critical point and must act to begin reducing that ratio. In order to do that, the Board must amend its traditional commensurate rent methodology and begin to base its renewal guidelines on factors which include a measure of inflation adjusted net operating income.

This year, the RGB staff has provided the Board members with alternative sets of commensurate rent adjustments: one based on the traditional approach, and one based on an approach which includes an inflation adjustment for net operating income. The inflation adjusted commensurate rent increase should serve as the minimum rent increase necessary to keep rental property owners whole this year.

In addition, the decline in net operating income must be

reversed by providing guideline increases substantially above the minimum required. Only by providing rent guidelines substantially higher than the commensurate rent adjustment can the economic viability of rental housing be restored. Such higher rent guidelines are required in order to start bringing the 13% of stabilized buildings which are operating in the red back into the black.

The Board may draw some solace from the fact that weak market conditions will temper the effect of the substantial rent increase now required. Owners trying desperately to retain rent paying tenants will be extremely reluctant to raise rents higher than market conditions will allow.

Vacancy Allowance

This year, there is an additional incentive to provide a substantial vacancy allowance. In many cases, because of weak market conditions, owners are not able to collect the vacancy allowance and are, in some cases, bringing rents down below the level currently in effect. Thus, a vacancy allowance will only affect those rents which are substantially below market levels and thereby help achieve the goal

of providing a transition from rent regulation to a normal market of free bargaining between owner and tenant.

The vacancy allowance has traditionally been viewed by the RGB as "a means of maintaining the competitive position of rental housing relative to other investments without increasing the rental burden on tenants in occupancy". In other words, the vacancy allowance was viewed as a rent increase above and beyond the guideline increases needed to compensate owners for increased operating costs. At various times, it was cited as a means to compensate owners for costs not included in the price index or as means to compensate owners for inadequacies in prior guidelines.

We ask the Board to once again consider the vacancy allowance as an addition to the renewal guidelines and not as a part of a package of compensation for normal increases in operating costs. The vacancy allowance has been and can once again be an important means of generating needed rental income while holding harmless tenants in occupancy.

This year, we ask the Board to not only substantially increase the level of the vacancy allowance but to also provide a

floor for the level of vacancy adjustment equal to minimum cost of operating and financing residential apartments. For example, taking an average operating cost of \$382 per month and assuming the current operating margin, we arrive at a minimum rent of \$500 per month. Thus, the vacancy allowance would be expressed as a percentage increase on the legal rent or a minimum of \$500 per month, whichever is greater.

The arguments advanced in opposition to any vacancy allowance whatsoever are specious. The current argument is that the vacancy allowance builds inequities in the market by creating widely disparate rent levels for similar apartments. Conversely, it could more accurately be argued that it is historically low rents, created by the RGB's failure to pass through required rent increases to tenants in occupancy, which has resulted in the current rent skewing of the market.

In the past, the RGB had the alternative of authorizing uniform rent increases for all tenants in occupancy or of holding those tenants harmless and disproportionately placing the burden of increased costs on new tenants. The RGB has histori-

cally chosen the later course of action and has thereby created a class of apartments which, as a result of long term occupancies, have rents below minimum operating costs.

Another argument in opposition to a vacancy allowance has been that the adjustment promotes harassment. This argument has been so discredited that it no longer appears to be seriously advanced. New York's anti-harassment legislation and regulations are the most rigorous in the nation and should serve to assure the RGB that, to the extent its actions might encourage harassment, the remedies and penalties to deal with it are in place. However, the overall level of tenant harassment has been demonstrated to be minimal and to bear no relationship to the level of the vacancy allowance.

In light of last year's RGB staff report on the vacancy allowance, it should be noted that the proposal for minimum rent upon vacancy would help to eliminate rent skewing among stabilized apartments. And, as the staff pointed out, a vacancy allowance was legislatively authorized when stabilization began and the RGB was mandated to determine

the amount of subsequent vacancy allowances.

Special Guideline

The reduction in the special guideline for formerly rent controlled apartments first entering rent stabilization over the last two years sends a message that the City and State have embarked on a concerted effort to divest New York's housing of private investment.

While this guideline does not apply widely, it does apply critically in those cases when an initial stabilized rent is challenged. In such cases, DHCR establishes the new legal rent by averaging comparable rents and the rent established by the RGB special guideline. Thus, a low RGB guideline has the effect of establishing a first rent even lower than that of comparable stabilized apartments.

The special guideline has traditionally been established as a percentage increase above the MBR or MCR. The special guideline was increased to 35% above the MBR in 1988 after RGB staff determined that rent controlled rents were on average 35% below rent stabilized rents.

The special guideline was reduced two years ago and maintained at that lower level with no discussion or basis. Such an action sends a mes-

sage to the housing industry that rent levels in New York will be held at arbitrarily low levels with no rational basis. Such a course of action must be reversed.

Unless the Rent Guidelines Board maps out a discernable, consistent and rational course of action which can serve as a basis for investment decisions in the housing market, there will be no future for private rental housing in New York City.

Water and Sewer Charges

The RGB has recognized the dangers which water metering billings represent for the rental housing stock. A preliminary analysis presented to the Board by Speedwell, Inc. demonstrated that the number of buildings operating in the red would increase significantly if water metered billings are universally applied to the City's low and moderate income housing stock.

Therefore, the Board was justifiably relieved to learn that the City administration would enact a two-year water and sewer rate freeze and place a \$500 per unit cap on metered billings. The Board was even more relieved to hear a legal opinion that, even if it wanted to, the Board could not enact a

rental surcharge on tenants where metered bills rose inordinately.

Unfortunately, the actions announced by the City are only temporary measures. The long term solutions to the problems of consumption based billings are not yet at hand. As a result, two year leases entered into under the guideline enacted this year may be subject to skyrocketing metered water and sewer bills.

Fortunately, despite the legal opinion presented to the Board, there is a mechanism available to help protect leases entered into under this guideline from the economic effects of metering. The Board can enact a provision which would provide that, if there is significant increase in water and sewer bills during the term of leases entered into under this guideline, such an increase would trigger an additional increase under a subsequent lease. For instance, if water and sewer bills increased by more than 50% under an Order 25 lease, then the subsequent lease would provide for an additional 1% increase.

If the Board is concerned with the potential damage from metered water bills, we urge the Board to enact such a provision. We do not believe that

pass-throughs are the solution to metered water costs. Many of the tenants in low income buildings most seriously affected by high consumption based billing will not be able to afford such pass-throughs.

However, if the RGB wants to affect public policy on this matter, if the RGB wants to hold the City's feet to the fire and ensure that a permanent solution to metered billing is implemented, then the surest method is to hold out the prospect that tenants will actually have to pay for their water consumption. We believe that if the RGB enacts such a measure, the City will ensure that it need never be implemented.