NEW YORK POST

Rent board proposes smallest hikes 'ever'

By DAVID SEIFMAN
City Hall Bureau Chief

The city's Rent Guidelines Board is proposing the lowest increases in the history of rent stabilization — 2 percent for one-year lease renewals and 4 percent for two-year deals.

The tentative hikes would affect ter nts in about 600,000 rent-s ilized apartm ith s expiring 1994 and

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The New York Times

Defaults Rise, Posing Peril For Housing

Giuliani Wants to Cut Costly Takeover Burden

By SHAWN G. KENNEDY

As the Giuliani administration tries to rid the city of the expensive task of managing thousands of homes and apartment buildings taken for nonpayment of taxes, a new wave of defaults is threatening to burden the city with thousands of additional units.

The number of buildings in which owners have fallen seriously behind in their taxes has risen sharply in the last five years, from 13,737 in 1989, to 18,003 in 1993.

Even more troubling to city officials is hat as the number of buildings in default as risen, the number of owners rescuing ir properties by paying off taxes h pped precipitously.

e properties are mostly decrepit s ranging from single-family hom apartment buildings with mo ts, generally in poor neighb

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A Submission to the NYC Rent Guideline Board Relative to Order No. 26

Rent Stabilization Association
Joseph Strasburg, President
Jack Freund, Executive Vice President
June 1994

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Introduction

The Rental Housing Crisis

Last year, we asked the Rent Guidelines Board to "confront and address the inescapable conclusion that New York's rental housing is mired in a deep and growing state of crisis." The Board addressed our concern by way of Resolution 93-1 which recognized that one in eight stabilized buildings was in economic distress. The resolution went on to identify various sources for the distress in the City's housing markets and called for combined study and action by a variety of involved City and State agencies.

We appreciate the RGB's recognition of significant problems for the City's stabilized housing stock. The RGB is now in concert with groups as diverse as the Community Service Society and the Citizens' Housing and Planning Council as well as the new City administration, all of which realize the threat of increased abandonment and City ownership of rental housing.

In addition the RGB should recognize the financial impact on the City budget as lost and deteriorated housing reduces tax revenues and increases expenditures, contributing to the New York City's fiscal crisis.

Everyone agrees that these threats should be mitigated. The question is how.

This year, we ask the Rent Guidelines Board to recognize that it can, and must, be part of the solution. To be part of the solution, the RGB must first recognize that it is part of the problem. It is curious that among all the factors identified in Resolution 93-1, (including sharp increases in real estate taxes and water and sewer charges, unreasonably high operating cost ratios, rising vacancy and collection losses and the inability of some tenants to pay higher rents), the only cause of distress omitted is the RGB's own role in excessively limiting rent increases and failing to provide owners with the rental income they need to maintain and operate their buildings.

We ask the members of the RGB to recognize that the effects of 25 years of stringent rent regulation cannot possibly be totally benign. Even the Executive Director of the RGB has acknowledged that some portion of the deteriorating economic condition of stabilized housing can be attributed to rent regulation. In this submission, we intend to focus on the detrimental effects of rent regulation and to demonstrate that these effects are significant. We would like to suggest how these effects can be ameliorated by actions of the RGB.

It is often difficult for individuals to accept responsibility for errors in their actions, and perhaps even more difficult for institutions to do so. It may be particularly difficult for current members of the Rent Guidelines Board to attempt to reconstruct and evaluate the actions of their predecessors. And any admission of past error or detrimental effect by the Rent Guidelines Board must be tempered by the consideration of the legal consequences. We understand these concerns. Nevertheless, the RGB cannot be part of the solution unless it acknowledges that it is part of the problem.

The Role of the RGB

The legislative mandate authorizing the RGB seems clear: it is the purpose of the RGB to set the permissible level of annual rent increases after considering a wide variety of factors affecting the health of the residential real estate market. Despite the simplicity of the legislative mandate, a number of theories regarding the role of the RGB have been proposed, often confusing the mandate of the RGB (to maintain the health of the housing industry) and the overall purpose of the rent stabilization system (to protect tenant). These theories deserve some attention, for there should be no confusion about the principles which guide RGB actions.

One theory put forth is that it is the role of the RGB to "simulate" what rents would be in an otherwise competitive unregulated market. If this is the role of the RGB, one may well ask why we need a regulatory system at all. If we want to "simulate" a private market, we should just lift rent regulations and there would no need to simulate. We would simply have a free competitive housing market just as it exists in most of the United States and the rest of the world.

On the other hand, we need to consider the difficulties of actually trying to simulate a private housing market. A housing market as large and diverse as New York City's is not one market, but many submarkets. Each of these submarkets is governed by its unique parameters and each building within each sub-market is governed by the business decisions of individual owners, each with their specific business practices and investment expectations. It should be evident that no regulatory Board can simulate the richness and diversity of a large private housing market, certainly not by establishing city-wide average guidelines, and not even by attempting to fine-tune rent guidelines to specific situations.

Another proposed theory is that the purpose of rent stabilization, and presumably the role of the RGB, is to inject "some fairness into a failed market". But what fairness is there in a system which results in vastly different rent levels for similar apartments and services? How is it fair that a low income household with children should pay more in rent than a higher income single tenant? Where is the fairness in allowing property owners to absorb operating cost increases without commensurate increases in rent? Why is it fair to regulate the price of rental housing but not the price of groceries or clothes? If fairness is the goal of rent stabilization, the system has failed badly.

Under the theory of fairness, protecting poor renter households is simply a by-product of the rent regulatory system. It does not matter, under this theory, whether a tenant household earns $250,000 per year or $6,000 per year, they deserve the protection of "fair" rents.

Yet the dynamics of the rent regulation system and the Rent Guidelines Board process are clearly driven by the concern of and for low income households, some of whom cannot afford to pay any rent whatsoever. Why else would the RGB spend hours listening to the testimony of tenants whose only complaint is that they cannot afford to pay more rent? Why would the Board, in its explanatory documents, take into balance the need of owners for rent increases to meet operating costs and the inability of some tenants to afford additional rent increases?

The goal of balancing the needs of owners and the concerns of tenants arises from a confusion about the role of the RGB (to help owners meet increased costs) and the purpose of the rent stabilization system (to protect tenants from exorbitant rent increases). It is our understanding of the system that the overall limitation on permissible levels of annual rent increase (along with the other rent and eviction provisions of the law) provides tenants with as much protection as possible, while the provision of **adequate** levels of rent increase by the RGB should minimally allow owners to stay in business. We understand that the members of the RGB cannot be oblivious to the purpose of the regulatory system, but neither should they ignore the mandate of the Rent Guidelines Board.

How the RGB Can Help

The Rent Guidelines Board has presided over continuously increasing operating cost ratios, both in the long-term and in the short-term. As a result, hundreds of thousands of apartments have been lost and a significant additional universe is now threatened. The members of the RGB now have an obligation to take responsibility for their legislative mandate by addressing well established deficiencies of the regulatory system.

This year, the RGB is presented with an unrealistically low Price Index of Operating Costs (PIOC), well below increases in the overall pace of inflation. In the past, when confronted with spikes in the PIOC, the RGB has invoked a "smoothing" theory in which rent increases lower than required were justified by "the need for rent increases to take a more stable course of adjustment than the short term movements of operating costs evidenced in the Price Index of Operating Costs" (Explanatory Statement, 1991).

The "smoothing" theory should now be invoked to provide rent increases substantially higher than indicated by the price index. This is necessary to compensate for the inadequacy of recent guideline increases and to begin reducing unrealistically high operating cost ratios.

In addition, the RGB needs to substantively address the problem of low rent apartments, those apartments with rents below the level needed to meet operating and maintenance costs, not to mention the costs of financing and a return on investment. These are the apartments which constitute the core of buildings with operating costs in excess of income and which are threatened with abandonment. In this submission, we will focus on these low rent units to demonstrate that they are adversely affected, to an inordinate degree, by the rent regulatory system.

Finally, we ask the members of the Board to reconsider their decision to restrict and reduce the vacancy allowance to an unrealistically low level, especially as it affects low rent apartments. Through the vacancy allowance, the RGB has an opportunity to inject much needed capital flow into rental housing while meeting its other objective of protecting tenants in place.

In short, there are a wide variety of problems plaguing the regulated housing market in New York, and many of these factors are beyond the control of the Rent Guidelines Board. But regulating the flow of income into rental buildings is a direct responsibility of the RGB and, in this area, the RGB can provide significant relief to an ailing industry.

Responsibilities of the Rent Guidelines Board

The rise in operating cost ratios for rent stabilized apartments is indisputable. By the broadest measure, the percentage of rental income spent on operating costs has increased from 55% in 1971 to 76% in 1992. In the short term, as reflected by income and expense statements filed with the Department of Finance, the operating ratio continues to rise. The RGB staff has spent considerable time and effort in minimizing the extent of the increase in operating ratio and in attributing the causes of this increase to any factor other than the actions of the Rent Guidelines Board. We would like to indicate the ways in which the rise in operating ratios is directly attributable to RGB actions and policies, not for the purpose of assigning blame, but simply to point out that the RGB can contribute to a reversal of the trend of economic deterioration evident in the stabilized housing stock.

Effect of Average Rent Increases

The Board acknowledges that it dispenses rough justice by providing city-wide rent increases based on the average increase in operating cost for all buildings. Passing on average increases in costs can have dire consequences when some buildings consistently suffer from above average increases in operating costs. This is the case for real estate taxes, which now constitute approximately 25% of average operating costs. As indicated in Table 1, rental buildings in some of the City's poorest neighborhoods have consistently suffered from larger increases in real estate taxes than the City-wide average increase in taxes -- increases which are more than three times higher than the average. When the Board incorporates an average increase in taxes in the permissible guideline increase, it disadvantages

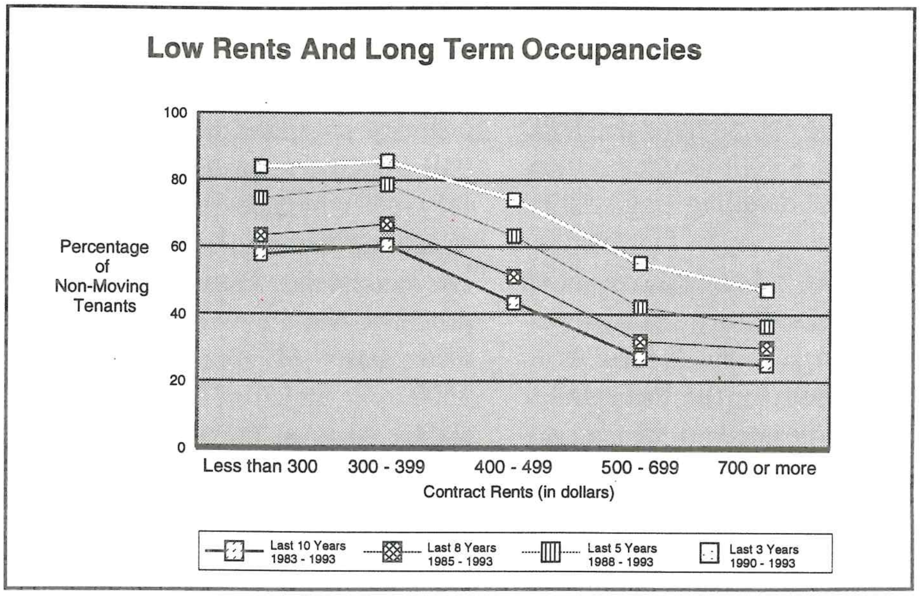
Average Real Estate Tax Increases

Community District		1987-88	1988-1989	1989-90	1990-91	1991-92	1992-93	Cumulative
City Wide		8.10%	15.76%	12.05%	12.8%	11.11%	3.11%	81.20
S.E. Bronx	1	6.87	31.03	20.43	23.8	23.0	15.1	195.57
	2	21.21	20.26	30.70	26.0	24.1	8.9	224.42
	3	12.01	17.62	39.55	34.1	25.0	6.3	227.60
Crown Hts.	8	9.00	19.45	15.25	18.7	21.6	5.1	127.64
East NY	9	6.51	24.28	13.27	18.2	15.2	7.1	118.66
West Harlem	9	15.1	25.99	13.27	8.4	8.5	7.3	107.24
Upper Eastside	8	10.5	14.02	11.60	12.4	8.8	1.7	74.87

Sources: Price Index of Operating Costs for Rent Stabilized Apartment Houses in New York City 1988 - 1994.

Table 1

these buildings, making it difficult for them to continue to meet their tax obligations while maintaining the buildings. It is not coincidental that the neighborhoods suffering from above average property tax increases contain the buildings which are threatened by abandonment.



Source : 1993 New York City Housing and Vacancy Survey

Table 2

Long-Term Tenancies

Throughout its history, the RGB has consciously adopted policies which unduly protect longer term occupants from the consequences of increases in operating costs. By virtue of lower rates of rent increase for multi-year leases, a tenant who has been in continuous occupancy since the inception of rent stabilization will have experienced only a 189% increase in rents versus a 329% increase in the consumer price index. Certainly, such tenants have not only been protected from exorbitant rent increases, they have gotten a very nice bargain indeed.

We understand the reluctance of the Board to subject long term occupants to additional rent increases. However, if these tenants are not paying their fair share of operating cost increases, someone else has to pay the freight. In a normal housing market, an owner may choose to provide a preferential rent to a long term occupant but, in that case, the owner would have the option of making up for the shortfall from other renters. However, the Rent Guidelines Board has not factored into its renewal guidelines or vacancy allowances the shortfall created by long-term tenancies.

In this context, it is important to note that long term tenancies are directly related to low rents (see Table 2). Examining both the 1993 Housing and Vacancy Survey and DHCR rent registration data, we find that the amount of turnover is related neither to income level nor the number of units in a building but is directly related to lower monthly rents. Thus, the burdens of long term tenancies created by the RGB fall with particular weight on the owners of low rent apartments.

Failure to Update the Price Index

The Price Index of Operating Costs, a market basket of goods and services purchased by property owners, has not been updated in more than ten years. This would not be a problem if components of the market basket did not increase in excess of the rate of increase for the overall market basket. But various cost components did and continue to increase disproportionately.

To take just one example, consider the increase in annual boiler certification costs. While this filing requirement was an HPD responsibility, there were no filing fees or costs involved. With the shifting of the filing requirement to the Department of Buildings, a $30 annual filing was imposed and an inspection by a licensed plumber at a cost of $90-100 was required. Thus, a category of expense increased from zero to $130. At the same time, HPD imposed a 300% increase in its multiple dwelling registration fee. Each year, in fact, new or increased administrative costs are imposed on property owners, none of which have been recognized by the Price Index or incorporated in rent guidelines.

It is to the point to note that when the $10 per unit annual administrative fee was imposed in 1984, the RGB statute was specifically amended to mandate the RGB to consider administrative fee increases. This was an obvious invitation to the Board to pass along the newly created fee increase to tenants, but here again, the RGB failed to compensate owners for this fee increase.

Individually, these administrative cost increases are small, but cumulatively, they add up to substantial costs. Larger property owners have had to add personnel simply to deal with the administering bureaucracies. Smaller owners must spend more of their time dealing with the bureaucracy as best they can, subjecting themselves to substantial liabilities.

Just as administrative costs have increased, so have maintenance costs as a result of government mandate. Again, take just one recent example -- the promulgation of new lead paint removal guidelines, effective March 16, 1994. Under these guidelines, the costs of ordinary paint and plaster jobs will increase substantially and may even include the cost of relocating tenants. Even where no lead paint hazard exists, property owners will have to incur costs of approximately $500 per unit in laboratory testing costs to refute the presumption that there is a dangerous level of lead paint in the apartment.

In many other ways, every property owner has been severely disadvantaged by the failure of the RGB to update the Price Index.

Failure to Include Items Not in the Price Index

The general methodology of the RGB has been to apply increases in the Price Index only to that portion of rental income attributable to operating costs. This methodology has the effect of maintaining net operating income (rental income remaining after operating costs) at a constant dollar level. In other words, if an owner had net operating income of 35 cents of each rental dollar in 1971, the net operating income in 1994 would still be 35 cents, notwithstanding the fact that those 35 cents are worth much less today than in 1971. To make matters worse, operating ratios have risen substantially, so that net operating income had decreased even in constant dollars (See Table 3).

For several years, the RGB staff has proposed several alternative commensurate rent adjustment methodologies to

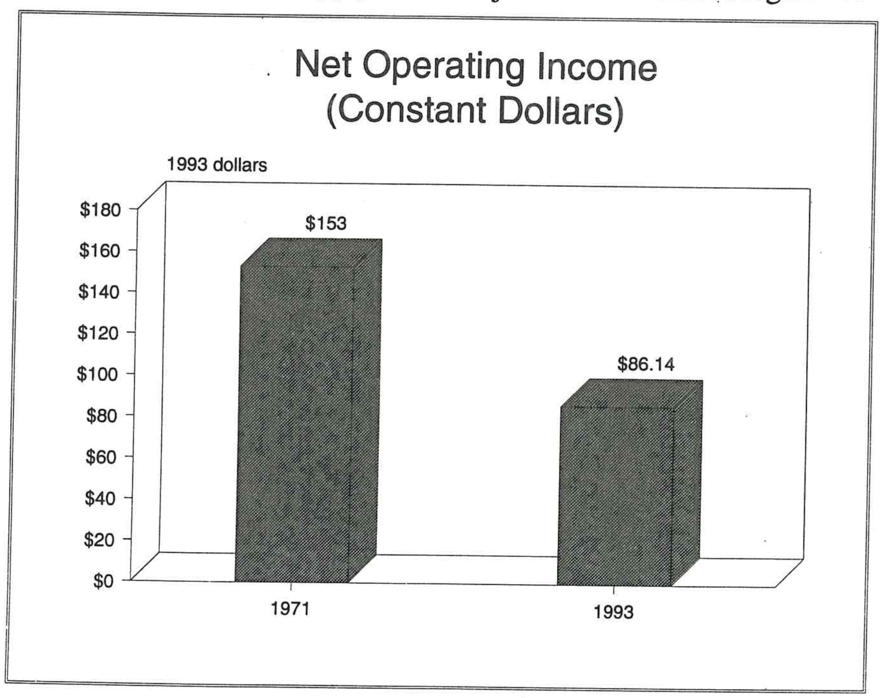


Table 3

compensate for the know deficiencies of the historic system. One proposal would account for the known distribution of one and two year lease renewals as well as the relative incidence of vacancy leases. Another proposal would adjust net operating income for the effects of inflation. A third approach, the most realistic of all, would combine the two prior proposals.

All of these alternative methodologies result in rent guidelines higher than those produced by the traditional methodology. Despite the rationality and availability of these alternative approaches, the Board, over the last four years, has chosen to enact rent guidelines even lower than those dictated by the traditional and least generous methodology.

The failure to provide rent increases to keep pace with operating cost increases has directly resulted in a rise in the operating ratio. This, in itself, should be a sufficient reason to adopt a commensurate rent methodology which at least adjusts for the actual distribution of lease terms. There are other strong arguments for using an approach which inflation adjusts net operating income. Since the inception of rent stabilization, the costs of financing and competitive rates on investment have increased sharply. Why would potential investors put money into New York housing when they know that the rate of return on their investment will not rise even when competitive rates increase? The failure to consider the costs of capital and the capital needs of the housing stock resulted in a serious deterioration of housing conditions and the competitive position of New York's housing industry.

Vacancy and Collection Losses

The RGB has taken note of an extraordinary level of vacancy and collection losses in the stabilized stock of approximately 15% of rent rolls. This compares with losses in the area of 2-3% for rental housing nationwide. The RGB has taken the equally extraordinary position that these vacancy and collection losses are not the concern of the Board since they are probably accounted for by market limitations on rent increases at the high end of the rent spectrum and the inability of tenants to pay at the low end.

It is extremely inconsistent for the Board to maintain that the rent paying ability of tenants is a valid consideration for the purpose of limiting rent increases but is not a valid consideration when low rent paying ability limits rent collections for owners. After all, in a private housing market, owners would compensate for the inability to collect rents at one level by increasing rents at levels where they are collectible. If the RGB were trying to mimic a private market, it would accord owners the ability to compensate for uncollectable rents.

There are a number of factors which affect the health of the housing industry which are outside of the control of the RGB and which are not the result of RGB actions. However, we have enumerated here a number of factors which adversely affect the industry and which are either the direct result of RGB actions or which could be affected by such actions. Serious consideration of these items can only to lead to the conclusion that the rent stabilization system has adversely affected the housing market and that the RGB now has an obligation to take remedial measures.

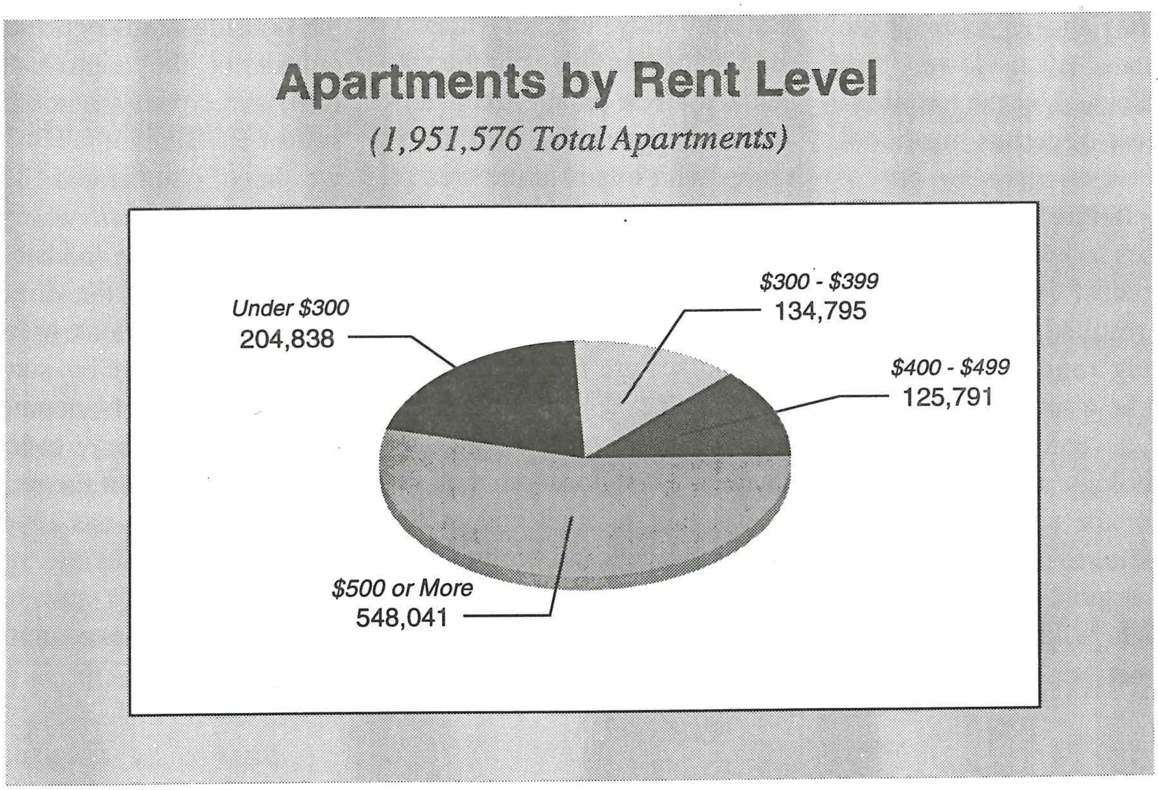
The Special Problem of Low Rents

The rent stabilized stock contains nearly 91,801 units renting for less than $300 per month; 212,022 units renting for less than $400 per month and 396,357 units renting for less than $500 per month. In addition, these same rent stabilized buildings contain 33,990 rent controlled units renting for less than $300 per month; 48,565 controlled units renting for less than $400 per month and 69,068 controlled units renting for less than $500 per month (See Table 4).

At the same time, various sources indicate that the minimum cost of operating and financing rental buildings is in excess of $500 per month. For instance, if we take the average adjusted operating cost for stabilized buildings, $366 per month, and assume a 70% ratio of rents to operating costs, a minimum rent of $520 per month is indicated. Yet, 43% of apartments in stabilized buildings rent for less than the minimum cost of maintaining and financing these buildings. If we look at just stabilized apartments, 40% rent for less than the minimum required rent.

RGB Policies Keep Rents Low

These low rent apartments jeopardize the economic viability of rental housing and are a major cause of the new wave of housing abandonment which threatens the City. It has been commonly assumed that some apartment rent levels are constrained and kept low by the tenants' ability to pay. While this may be true in some cases,



Source : 1993 New York City Housing and Vacancy Survey

Table 4

in many other cases rents are kept low by the policies and guidelines adopted by the RGB, both over the long term and in the short term.

An examination of annual rent registration data in conjunction with HVS data and operating data reveals a wealth of information about the characteristics of these low rent units which were previously unavailable. This data indicates that the RGB has played a critical role in keeping rents at unrealistically low levels:

- low rent apartments are concentrated in low rent buildings.
- low rent apartments have lower rates of rent increase than high rent apartments.
- low rent apartments experience fewer turnovers than high rent apartments.
- low rent apartments are subject to fewer and less costly MCI improvements than high rent apartments.
- low rent apartments have higher operating costs per unit than high rent apartments.
- low rent apartments have insufficient income to meet their true maintenance and operating costs.
- tenants in low rent apartments often have the ability to afford higher rents.

In light of these characteristics of low rent apartments, it is not surprising that properties acquired by the City through tax foreclosure are principally low rent buildings. Over time, low rents simply cannot sustain these buildings. And these low rents are a direct result of actions taken by the Rent Guidelines Board.

Low Rents Not Limited By Low Incomes

It has sometimes been assumed that rents in the City's poorer neighborhoods are held low, not by rent guidelines, but by the income paying ability of tenants. In part, this assumption may have been created by the perception that there are a significant number of low rent apartments whose actual rents are lower than their legal rents. A closer examination of rent registration data reveals that the majority of low rent apartments with actual rents lower than the legal consist of subsidized tenancies receiving SCRIE or Section 8. On the other hand, the majority of high rent apartments where actual rents are lower than legal rents represent true preferential rents where market conditions, and not necessarily rent paying ability, have limited the rent levels.

While there are obviously some tenants who cannot afford higher rents, it is equally true that at every rent level there are a range of incomes such that many households can

Low Rents Have Room To Rise
(All stablized households - 1993 HUS)

Percent Households with Rent/Income Ratios Below:	Units with Contract Rent Less Than:		
	300	400	500
15%	18.9%	21.2%	20.7%
20%	33.6%	33.6%	32.9%
25%	46.1%	44.9%	44.8%
30%	55.1%	52.9%	52.6%

Source: 1993 NYC Housing and Vacancy Survey

Table 5

afford rent increases. Table 5, reflects the fact that the majority of households in low rent apartments pay less that 30% of income for rent and can afford higher rents.

One should also note that HPD rehabilitated buildings are able to command rents above the average for the neighborhood in which they are located. Further, more than half of welfare recipients pay rents which are lower than the shelter rent allowance. Thus, while in some cases rents may be held down by rent paying ability, this is not generally the case. Rather, rents have been kept low by rent guidelines practices.

Need For Low Rent Adjustment

Largely to blame is the practice of averaging cost increases and enacting average rent guidelines. The RGB calculates an average percentage cost increase which results in given dollar increase on an average rent. Applying a uniform percentage increase to all rents results in a smaller dollar increase for lower rent units and a higher dollar increase for high rent units.

For several years, the RGB recognized this principle and implemented a supplementary adjustment for low rent apartments. However, a few years of low rent adjustments were not sufficient to compensate for the decades of inadequate increases resulting from the application of average guidelines. Nor were they sufficient to compensate for relatively low turnover in low rent apartments and the fact that these apartments could sustain relatively few major capital improvements and individual apartment improvements.

Low rent apartments create major problems when they are concentrated in low rent buildings, but they are also problematic in high rent buildings. Operating costs do not decrease for low rent apartments in high rent buildings. Rather, the high rent apartments subsidize the operating cost of the low rent apartments. This becomes critical when the Board decides that higher rent apartments do not need vacancy increases or that there is some magic number which indicates an adequate rent.

Nor does the Board often consider that, spread throughout the housing market, one out of ten rent regulated apartments is a rent controlled apartment with an average rent approximately 30% lower than the average stabilized rent. While the Board has no jurisdiction over rent controlled apartments, these low rent apartments affect the economics of stabilized buildings and need to be taken into consideration when setting stabilization guidelines.

The RGB has recognized the problem of distressed properties and we now have a better picture of the source of distress: the problem is not so much low incomes as it is low rents which are a direct result of the actions of the RGB. Unless the RGB reinstitutes a supplementary adjustment for low rent units, the spread between low rents and what it costs to maintain and operate buildings will continue to increase and so will the number of distressed properties.

The Vacancy Allowance

The Rent Guidelines Board has traditionally used the vacancy allowance as means of providing needed cash flow to the rental market without affecting tenants in place. Over the history of the guideline process, various rationales have been provided for the vacancy allowance ranging from increases in costs not accounted for in the Price Index, to the need to reduce operating cost ratios. In only one year of the past twenty five guidelines has the Board failed to provide a vacancy allowance. During the other guidelines, the vacancy allowance has ranged from a high of 15 percent to the current low of five percent.

Need For Vacancy Allowance

There is ample economic justification now for a substantial vacancy allowance. Operating ratios are at an all time high and are continuing to rise. One out of eight rent stabilized buildings is operating in the red just on an operating cost basis. At the same time, the effects of recession on tenant incomes make the Board reluctant to pass through the substantial guideline increases necessary to begin to reduce generally high operating ratios. It would appear that a substantial vacancy allowance is more necessary now than ever before in order to provide a substantial cash infusion to the housing market while holding harmless all tenants in place.

Even without economic justification, it would seem that the vacancy allowance should be a permanent and necessary fixture of the regulatory system. In the context of the wide ranging discussions regarding the goals and purposes of rent regulation, the express language of the statute is clear: "it is the goal of public policy to provide for a transition to a normal market of free bargaining between landlord and tenant" The vacancy allowance provides a slow and painless means of achieving the expresses goal of the regulatory system. Unless the RGB wishes to contravene the express intent of the enabling legislation, it should be the burden of those who wish to maintain rent regulations forever, rather than as an emergency measure, to demonstrate why an across the board vacancy allowance should not be routinely approved, even in the absence of economic justification.

Some advocates have argued that a vacancy allowance is not necessary because owners can avail themselves of 1/40th individual apartment improvement rent increases and other mechanisms such as Major Capital Improvement (MCI) increases to raise rents. Again, such broad characterizations fail to reflect the realities of the housing market.

An analysis conducted by DHCR indicates that 1/40th and MCI rent increases are not uniformly distributed but generally take place in the City's wealthier neighborhoods where there is a large gap between regulated and market rents. In such neighborhoods, owners generally have the resources to carry out substantial improvements and tenants have the ability and willingness to pay for such improvements. It should be noted that even in strong market areas, substantial improvements are a one-time event. Substantial improvements are not carried out upon every vacancy in order to keep increasing rents, because even in strong market areas there are natural market limitations on rent levels.

Improvement increases are least likely to occur in low rent neighborhoods, where rent increases are most necessary for the survival of the housing stock. This phenomena has been confirmed by an analysis of rent registration data. Thus, the irony of the vacancy allowance authorized by the RGB is that it provides the least benefit where the greatest benefit is needed. In low rent neighborhoods, where the vacancy allowance is the only means for owners to substantially increase unrealistically low rents, the five percent vacancy allowance holds rents down. In high rent neighborhoods, where owners are able to improve apartments, the vacancy allowance is less critical (however, it must be noted that the vacancy allowance is critical in some high rent situations, for instance where improvements have already raised apartment rents and cannot be justified again, but where there is legitimate need for the vacancy allowance).

All Apartments Need A Vacancy Allowance

It is noteworthy that the RGB did not provide any justification for its action last year in reducing or eliminating the vacancy allowance for apartments renting for $500 or more per month from its already historically low level of five percent. Informally, some Board members stated that they were trying to help owners of low rent apartments. However, it is difficult to see how these low rent apartments would be helped if they were given no more than they have previously received. It is equally difficult to perceive why any segment of the market should not be able to avail itself of a vacancy allowance, unless the Board's action was grounded in a fundamental misperception of the way the rental housing market operates.

The Board heard testimony last year that, at the high end of the market, owners could not collect a vacancy allowance and, in some cases, owners were negotiating lower rents upon renewal of leases. This may have led the Board to determine that if vacancy allowances were not collectible, then there was no need for the Board to authorize them.

However, given a rental market as large and complex as that of New York City's, it is never possible to make a categorical statement and assume that is will be true across the spectrum. While some owners in some cases may not have been able to increase rents or collect vacancy allowances, these cases were in the minority. Our data indicates that true preferential rents occur primarily at higher rents and comprise approximately 8% of all stabilized rents. Thus in the majority of cases, vacancy and renewal guidelines have been and can be collected at the higher rent levels, yet owners are being denied increases without basis.

Some Board members may believe that above a certain rent level, perhaps $1,000 per month, owners are well able to meet their maintenance operating costs and simply do not need higher rent levels. Such a view ignores certain characteristics of the housing market.

It is well known that rent regulation causes rent levels in the same building for similar apartments to vary widely. It is equally true that the higher the average rent for a particular building, the more likely that the building will contain very low rents as well as relatively high rents. (see Table 6 which

DISTRICT	AVERAGE RENT IN BUILDINGS BY AVERAGE RENT CLASS										
	Under $99	$100-199	$200-299	$300-399	$400-499	$500-599	$600-699	$700-799	$800-899	$900-999	Over $1,000
Brooklyn	70.88	158.94	261.63	360.24	452.25	542.66	638.27	739.19	850.67	944.66	1,391.74
Bronx	66.18	157.64	269.42	354.87	450.50	539.52	642.19	753.94	827.69	946.68	1,095.92
Manhattan	73.67	154.18	261.21	358.40	451.39	548.27	647.44	746.65	845.67	948.99	1,350.16
Queens	47.76	169.46	274.33	370.11	455.11	547.25	641.66	736.84	852.61	916.29	1,142.04
Staten Island				370.94	464.43	538.51	644.61	713.11			

DISTRICT	AVERAGE STANDARD DEVIATION WITHIN BUILDINGS BY AVERAGE RENT CLASS										
	Under $99	$100-199	$200-299	$300-399	$400-499	$500-599	$600-699	$700-799	$800-899	$900-999	Over $1,000
Brooklyn	15.63	88.61	87.87	84.29	92.25	106.59	108.74	188.94	204.46	198.37	367.70
Bronx	28.28	124.45	120.18	125.70	114.84	118.61	145.55	173.33	212.99	240.36	176.53
Manhattan	21.52	41.09	71.21	92.49	114.41	148.23	170.97	200.25	230.46	258.93	417.47
Queens	15.10	31.92	124.03	86.85	90.01	108.72	120.09	142.87	209.12	251.73	379.00
Staten Island				73.59	75.59	72.18	132.07	120.55			

Source: RSA Rent Registration data

Table 6

illustrates dispersion around average rent levels). In other words, as the average rent level increases, the greater the range of rents around the average. In addition, low rent rent controlled units are spread throughout the housing inventory.

At the same time, buildings which can command higher monthly rents generally have higher operating costs. High rent buildings generally have larger staffs of doormen, porters, etc. and therefore have higher labor costs. Given their higher rental income and better locations, these buildings pay more property taxes. And since these factors give such buildings greater value, they have higher financing costs.

In short, buildings with high average rents also contain apartments with relatively low rents which do not meet the building's higher average operating and financing costs. The higher rents in these buildings, to a large extent offset the deficits created by the lower rent apartments. Because the lower rent apartments rarely turn over, owners must be able to increase rents in the higher rent apartments to offset the lower rent units. Denying owners of higher rent units the ability to collect vacancy increases diminishes the profitability of these buildings, and eventually threatens their economic viability.

The housing market currently seems to be tightening up slightly, permitting owners to collect vacancy and guideline increases where they may have been foregone in the past. But even in the last few years, owners have been able to collect a vacancy allowance on an $1,100 per month rent, if not on a $1,800 per month rent. If owners were previously denied a vacancy allowance only because it was not collectible, they should now be allowed a vacancy increase as it once again becomes collectible.

There are many reasons to permit a vacancy allowance to be collected across the board: the need to increase industry-wide operating ratios; the need to compensate for losses in low rent apartments by increasing rents in high rent apartments; and the overall goal of raising rents to market levels so that the normal mechanisms of supply and demand can express themselves to create an efficient housing market.

That said, there is also justification for skewing the vacancy allowance so that lower rent apartments are entitled to higher vacancy allowances than higher rent apartments, so long as no apartment is denied a vacancy increase. The data clearly reveal that even in the lowest rent levels, there is an ability to raise rent levels significantly above five percent, just as there is a willingness and ability among renters to afford the higher rent payments. Where the difference between low rents and operating costs or market rents is large, a larger vacancy allowance should be permitted.

Housing Affordability

It is striking that, despite the recent decrease in housing affordability recorded by the Housing and Vacancy Survey, rental housing in New York City remains remarkably affordable on average, and even more so when compared with housing affordability in the rest of the country. During the inflationary era of the 1980's, the rent to income ratio in New York remained virtually unchanged, barely increasing from 25.5% in 1981 to 25.8% in 1991. At the same time, in the rest of the country the ratio increased significantly from 23.2% to 26.7%.

Housing Remains Affordable

Even the rise in contract rent to income ratios from 25.8% in 1991 to 28.2% in 1993 leaves stabilized tenants in New York in an enviable position in the context of a standard which now views paying 30% of income for rent as a general standard below which tenants do not need to be subsidized. The affordability of stabilized housing in New York becomes even clearer when one considers that the average contract rent to income stands at just 24.5%.

And the City's relatively large stock of low rent apartments ensures that even renters on public assistance have a substantial stock of housing available, even with their limited needs. According to the Coalition for the Homeless, with an average shelter rent allowance in New York City of just $286 per month, it is remarkable that the majority of welfare recipients, 52%, are able to find housing within the shelter allowance. This is in sharp contrast to other localities throughout the State where 64% to 93% of the households pay rents in excess of the shelter allowance.

The affordability of rental housing in New York City is largely accounted for by the relatively large stock of low rent apartments. Looking forward, an improving local economy, as indicated in the 1994 first quarter employment increase, promises to raise household incomes and reduce rent burdens.

Tenant Incomes Are Under-Reported

The affordability of housing in New York City is even greater then the boldface numbers indicate. It is commonly acknowledged that household income is under-reported in surveys. In addition, one-third of stabilized renters polled in the HVS don't report any income whatsoever. That is why the Census Bureau, in every survey it conducts other than the New York City HVS, routinely adjusts incomes for under-reports and non-reports. And that is why the City has contracted with the Census Bureau to apply the same income adjustment methodology to the HVS data. When these adjustments are finally made available, it will be clear that the percentage of income spent on rent by stabilized renters is even lower than the already low estimates.

Recent work by Harry I. Greenfield (Invisible, Outlawed, and Untaxed: America's Underground Economy; Praeger, 1993) estimates that 7.6% of national income is under-reported (not including theft and fraud). If we apply this factor for tenant under-reporting, the average contract rent to income ratio declines from 24.5% to 22.7%.

Affordability indexes based on reporting of income need to be viewed with great suspicion. Consider the unlikely findings from the 1991 HVS that 8% of all renters report paying gross rent in excess of income and that 18% report paying more than 90% of income for rent. In fact, Henry Aaron of the Brookings Institute, among others, has demonstrated that rent burdens based on the Bureau of Labor Statistics consumer expenditure surveys are regularly lower than those based on income.

Responsibility For Low Income Tenants

Just as the reporting of income and expenses should be treated similarly for tenants and owners, the exceptional cases at the margin of the income spectrums should also be treated similarly. It has often been remarked that the 13% of stabilized buildings which are losing money should not be of concern to the Rent Guidelines Board but should be addressed through the hardship provisions of the law, or through other governmental programs which would lower real estate taxes and other burdens carried by these buildings.

If that is the case, then those tenants who carry an unusually high rent to income burden as a result of low or no incomes should also be viewed as concerns of some governmental function other than the RGB. The needs of such tenants should be addressed through income supplement programs such as adequate shelter rent payments. On the other hand, if the RGB wishes to maintain that because income supplementation programs are inadequate, tenants with low incomes become the concern of the RGB, then it also makes sense to say that because there is no workable hardship program, the needs of distressed buildings become the concern of the RGB.

The concern which should be properly before the RGB is that if the Guidelines Board fails to increase rents as required because of affordability considerations, then the viability of housing will be jeopardized and those who apparently cannot now afford rent increases will have no housing opportunities at all in the future or will be limited to public housing at taxpayer expense.

The Board is clearly on the right track in calling for an inter-governmental effort to address the issue of housing at risk. That effort should also include the needs of rental households at risk. But the Board would abdicate its legislatively mandated responsibility if it failed to provide necessary guideline increases based on considerations of housing affordability.

We ask the Board to bear in mind that, after years of governmental commitment to being the producer and provider of affordable housing, there is now a new direction evidenced by a new administration. The new City administration recognizes that government cannot continue to be the housing provider of last resort, but must rely on the private sector to maintain its traditional role of providing a broad and vast range of housing opportunities. The RGB has a role to play in this new goal by ensuring that private housing is given every opportunity to remain in private hands.

The Condition of the Housing Industry

There is now a common perception that a large segment of the stabilized housing stock, one out of every eight buildings, is in dire financial condition and is in danger of falling out of the bottom of the rental market. It should be equally clear that this segment is just the tip of the iceberg and reflects the ever worsening economic condition of the industry as a whole.

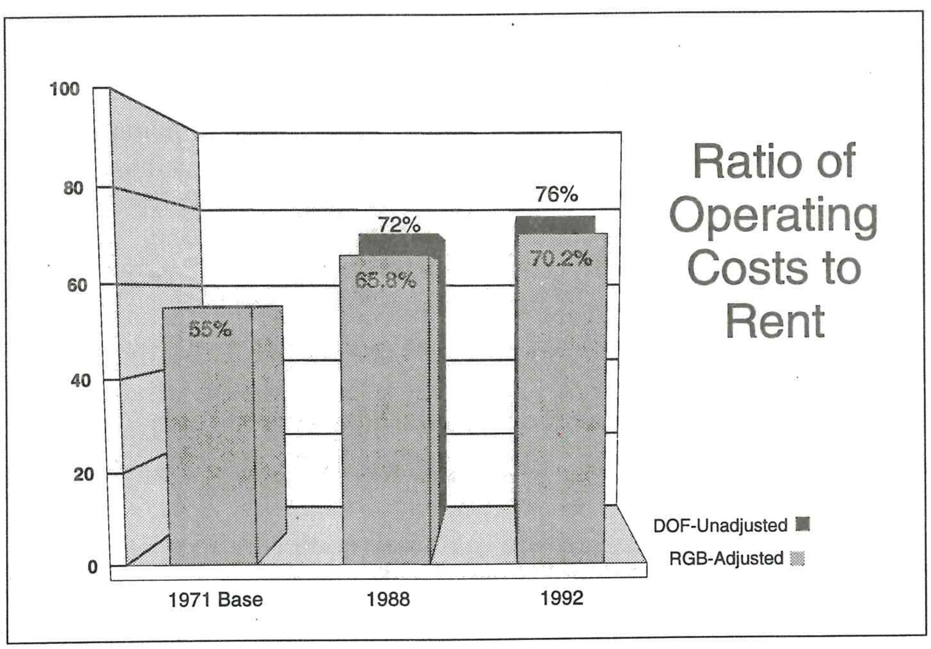
Operating Ratios

There is no question that operating ratios, the percentage of rental income spent on maintenance and operating costs, have risen in the short term. During the period in which consistent data has been available from income and expense statements filed with the Department of Finance operating ratios have increased no matter how defined (See Table 7). On an adjusted basis (adjusted for audit results) operating cost to gross income ratios increased from 59.6% in 1988 to 63.4% in 1992 while operating cost to rent ratios increased from 65.8% to 70.2%. Over the same time period, on an unadjusted basis cost to income ratios increased from 65% to 68% while cost to rent ratios increased from 72% to 76%.

Which measures should be used and what do they mean? In computing its commensurate rent increases, the RGB has traditionally and appropriately used the operating cost to rent ratio. Since only a small percentage of stabilized buildings benefit from commercial income, it would be inappropriate to use a measure which assumes that commercial income from a small percentage of buildings effects the economics of all stabilized buildings.

We would also argue that it is inappropriate to use the audit adjusted numbers. It should be clear that the majority of items eliminated were **legitimate** expenditures that were miscategorized. As for unsubstantiated expenses, it seems equally clear that a majority of those cases involved owners who kept poor records but may well have expended the stated amounts.

As to the significance of the rise in O&M ratios, there has been an attempt to both minimize the extent of the increase and to attribute its causes to factors other than those under the control of the RGB. However, any increase in the O&M ratio is significant, particularly so when the increase has been consistent, both in the



Source: Rent Guidelines Board Staff material

Table 7

short term and the long term.

The RGB staff has attempted to adjust current operating ratios downward, first by adjusting for audit results and most recently by eliminating buildings with ratios in excess of 300%. However, the staff has never questioned the 1971 base of a 55% operating ratio. Certainly, if owners are over-reporting expenses now, they would have done so in 1971 and would have done so consistently regardless of whether expenses were reported on a survey or a government form. If current operating cost numbers are adjusted downwards, historic numbers should also be adjusted thereby reflecting the true increase in operating ratios.

Regardless of the cause of the increase in O&M ratios, the RGB is obligated to try and reverse the trend and improve the health of the housing industry.

As a benchmark by which to measure the high operating ratios in New York, it should be noted that the annual income and expense analysis conducted by the Institute for Real Estate Management reveals that operating ratios across the country do not exceed 50% and that these ratios have been steady or falling over the last four years, in stark contrast to the situation in New York. Even in the Northeast, operating ratios do not exceed 50%.

If the RGB does not now draw a line in the sand and act to lower operating ratios, it is difficult to see at what point in the future that decision will be made, and operating ratios will march inexorably towards one hundred percent.

Maintenance Deficiency Indicators and Contract Rent
(All Stabilized Units, 1993 HVS)

Rent (in Dollars)	Mean Number of Maintenance Deficiency Indicators
Less than 400	2.02
400 - 499	1.89
500 - 699	1.53
700 or more	1.12

Source: 1993 NYC Housing and Vacancy Survey
Table 8

Building Conditions

There is a direct relationship between building condition and rent level (see Table 8). The HVS reveals that the mean number of maintenance deficiency indicators decreases as rent level increases. Thus, while tenants may benefit in the short term from low rents, the true cost of low rents is reduced building services. Ultimately, that cost translates into the loss of rental housing.

The amounts spent on operating and maintenance costs as reflected in income and expense filings do not necessarily reflect what is required to adequately maintain buildings, but what is available to be spent on maintenance. Similarly, when expense filings show a smaller rise in expenditures than would be indicated by increases in the Price Index, this may simply reflect the fact that owners have limited their maintenance expenditures to conform with limitations on the allowable increase in rents.

The Board's actions need to reflect the fact the a minimum rent is needed to adequately maintain and operate rental properties. Taking the lowest recorded operating cost of $320 per month for rental buildings in the Bronx and assuming a 70% operating ratio, a minimum rent of $450 per month would be required (as indicated earlier, the required rent level rises to more than $500 using a more realistic average operating cost expenditure).

The need for a minimum monthly rent should be viewed in the context that it costs HPD $450 per month to maintain its buildings **without** paying real estate taxes, water and sewer charges or insurance. In addition, one should consider that newly rehabilitated buildings placed into service by HPD have rents which range from $400 to $650 per month, with reduced debt service requirements and abated real estate taxes.

Sales Prices

The Board has been presented with sales price data which has been used to draw the conclusion that "it is very difficult to argue that rent stabilization has significantly impaired the value of multi-family properties over the last two decades." To the contrary it is very difficult to draw any conclusion whatsoever from the sales price data presented to the Board.

To engage in this debate, we would first have to assume that sales data has anything to do with the responsibilities of the RGB. Sales data is only relevant if the goal is to encourage the turnover of stabilized properties. If the goal is, as it should be, to encourage long-term ownership, the only relevant criteria is the net operating income generated by these properties.

To the extent that sales prices are relevant, one would have to analyze successive sales prices for the same rent regulated parcel over time and compare the price appreciation to similar non-regulated properties. Even so, one would have to factor in the value of those properties which do not change hands, probably because there are no buyers available at any price.

Lead And Insurance Costs

Each year, the Price Index of Operating Costs underestimates one or more components of building operating costs. This year, the most egregious example comes in the area of costs arising from lead paint abatement.

As a result of new Department of Health regulations, effective March 16, 1994, which mandate standards for the removal of lead paint, routine paint and plaster jobs have evolved into costly lead paint abatement projects. Virtually every peeling paint job in the City now requires extensive and costly procedures involving containment, clean-up, specialized equipment and, possibly, the relocation of tenants in occupancy. These increased costs are necessarily excluded from the Price Index which measures changes in the cost of a constant quantity and quality of goods and services. The Price Index, over the years, has consistently failed to capture increased costs resulting from new and changing government mandates including such items as waste recycling, asbestos removal and water metering.

The lead paint issue is also now significantly affecting insurance. Many insurance carriers have dropped out of the multi-family housing market. Twenty-six carriers have been granted lead paint exclusions by the State Insurance Department. The net effect of these changes is that insurance carriers are using lead paint as a pretext to leave the market or to substantially increase premiums where they are still writing policies. Informally, owners report premium increases ranging from 40% - 100%.

While the RGB staff made an attempt to evaluate the insurance impact of lead paint coverage, the attempt was inadequate and thwarted by the Price Index methodology. Most owners simply do not know whether or not they have lead paint coverage. Even where there is no specific lead paint exclusion, insurers are relying on the "absolute pollution exclusion" clause to deny coverage, thereby exposing owners to substantial liabilities.

This year, the RGB should take into consideration the new, ongoing costs associated with lead paint removal. The Price Index methodology should also be revised so that it will account for the unusual changes taking place in the insurance market as a result of lead paint liability.

Summary

RGB methodology and policies have resulted in substantial economic distress in the City's rental housing market. The leading edge of a new wave of housing abandonment is represented by the one in eight stabilized buildings which cannot meet their operating costs. Unless the RGB takes substantial action to remedy its past practices, these buildings and more will be lost from the private housing market.

Overall conditions in the rental housing market continue to deteriorate, with operating ratios continuing their upward creep, new governmental mandates imposing increased operating costs, and many low rent apartments unable to pay for needed maintenance and operating costs.

This year, the RGB is confronted with an unusually low Price Index of Operating Costs. We believe the Price Index excludes some increases in operating costs and smoothes out other increases through the use of averages. Thus, properties which had tax increases of more than 20% will not gain much relief from rent increases based on an average tax increase of 2.3%. Similarly, #6 oil users who saw price increases this year will be disadvantaged by the overall decrease in fuel prices measured by the Price Index.

In past years, when the Price Index was unusually high, the RGB failed to pass through the full cost increase. This year, we ask the RGB to enact rent guidelines substantially higher than indicated by the Price Index. Such increases are needed to compensate for inadequate guidelines of the past and to begin to restore operating ratios to a reasonable level commensurate with industry wide standards.

In addition to guidelines substantially higher than 2% and 4%, we ask the RGB to reestablish a supplementary adjustment for low rent apartments; those apartments renting for less than $500 per month which is the level needed to operate and meet the capital costs of rental property in New York City. Low rent apartments do not proportionately benefit from percentage guideline increases, nor from the vacancy allowance, nor from MCI and individual apartment increases. Unless a supplemental allowance is enacted, the gap between low rents and the amount needed to maintain and operate low rent buildings will continue to grow.

Finally, we ask the RGB to enact an across the board vacancy allowance at a level substantially higher than 5%. There is a compelling need for a vacancy allowance which should raise rents at least to the minimum cost of maintaineance and operation. The vacancy allowance has long been established as a means of improving the economic condition of the housing industry without affecting tenants in place.

This year, with a new administration in City Hall, with a new determination to encourage private sector growth and minimize the size and intrusiveness of government, the RGB needs to rise up to its mandate to promote the health of the residental housing industry so that it may provide decent private housing for all income groups.