Rent Guidelines Board Submission Order 39

June 2007

DAILY NEWS

"Rent increase may be lower this year" *May 8, 2007*

The New York Times

"Con Ed seeks to increase electric rates by up to 17%," *May 2, 2007*

The New York Times

"It takes money...when buildings need repair." *June 5, 2007*

DAILY NEWS

"Water Prices are killing us Monster rate hike in pipeline for City." *May 15, 2007*

CITY LIMITS

"Hard Costs. The rising price of an affordable New York." *Spring, 2007*

RSA Rent Stabilization Association

Joseph Strasburg, President
Jack Freund, Executive Vice President

Summary of Major Points

- Building operating costs are increasing at historically high levels (See page 3)

- Rent guideline increases are at historic lows (See page 6)

- Building economics have deteriorated as a result of low guideline increases. Since 2000, operating costs have increased by over 50% while RGB guideline increases totaled 25% or less (See page 8)

- Guidelines in the high range of commensurate increases and supplemental increases are needed to sustain regulated housing (See page 11)

- The need for higher rent guidelines cannot be offset by other income sources or affordability concerns (See page 15)

Building Operating Costs Are Increasing At Historic Highs

This year's 5.1% increase in the Price Index of Operating Costs (PIOC) represents a modest lull between last year's 7.8% increase in operating costs and an 8.5% increase projected for next year. Overall, the rate of increase in the PIOC has averaged 7.16% per year from 2000 through the current 2007 PIOC.

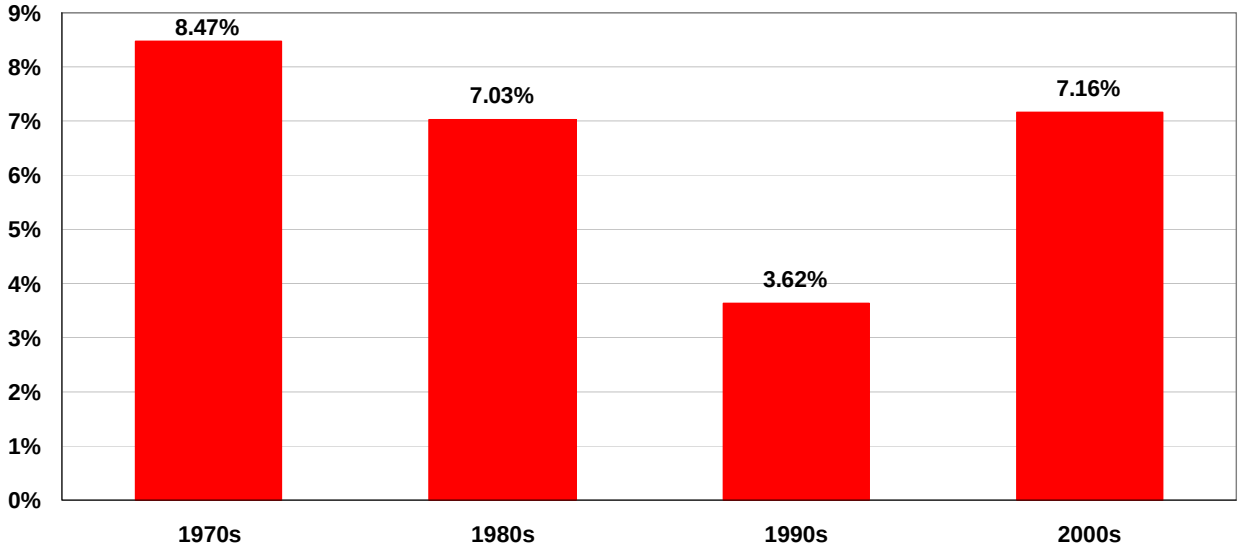
We are now in the midst of an extraordinary period of increased inflation for building operating costs which has not been seen since rent stabilization first began. Building operating costs have increased by more than 50% since 2000. And that increase does not include many additional cost increases not measured by the PIOC.

The increase in building operating costs stands in stark contrast to the relatively benign increase in the overall rate of consumer inflation in recent years. For example, the CPI for all urban consumers for the same April-to-April period as measured by the Price Index was just 2.5%, or half the increase in the PIOC.

The rate of increase in building operating costs is extraordinarily high compared to recent rates of increase or to historic rates of increase. For example, the 7.16% annual increase in operating costs is nearly twice as high as the 3.62% rate of increase in the 1990's (*see chart below*).

Building Operating Cost Increases are Near Historic Highs

Average Annual Increase of PIOC



Source: NYC Rent Guidelines Reports 1970-2007.

The current rate of operating costs increases is only exceeded by the rate of increase which prevailed in the highly inflationary period of the 1970's – a period of wide-spread inflation which was responsible for the creation of the rent stabilization system.

In contrast to the 1970's, the current inflationary trends have particularly affected rental properties, led by increases in municipal charges such as real estate taxes and water and sewer charges. Increases in heating and utility costs as well as insurance have also hit the rental industry hard.

Nor are rising costs likely to abate any time soon. Despite a proposed one-time reduction in the real estate tax rate for next year, increases in assessments will still result in increased real estate bills. Water and sewer bills are projected to continue increasing at double digit rates for the remainder of this decade. There is no prospect of reduced heating oil prices any time soon, if ever. And utility prices will likely rise in light of a request for double digit rate increases by Con Ed.

These significant increased operating costs are only those measured by the PIOC. There are other substantial costs which are not included in the PIOC, such as the cost of lead paint abatement and building façade improvement costs. The cost of complying with these and other governmental mandates imposed since 1983, when the PIOC was last updated, are not included in the cost increases presented to the RGB.

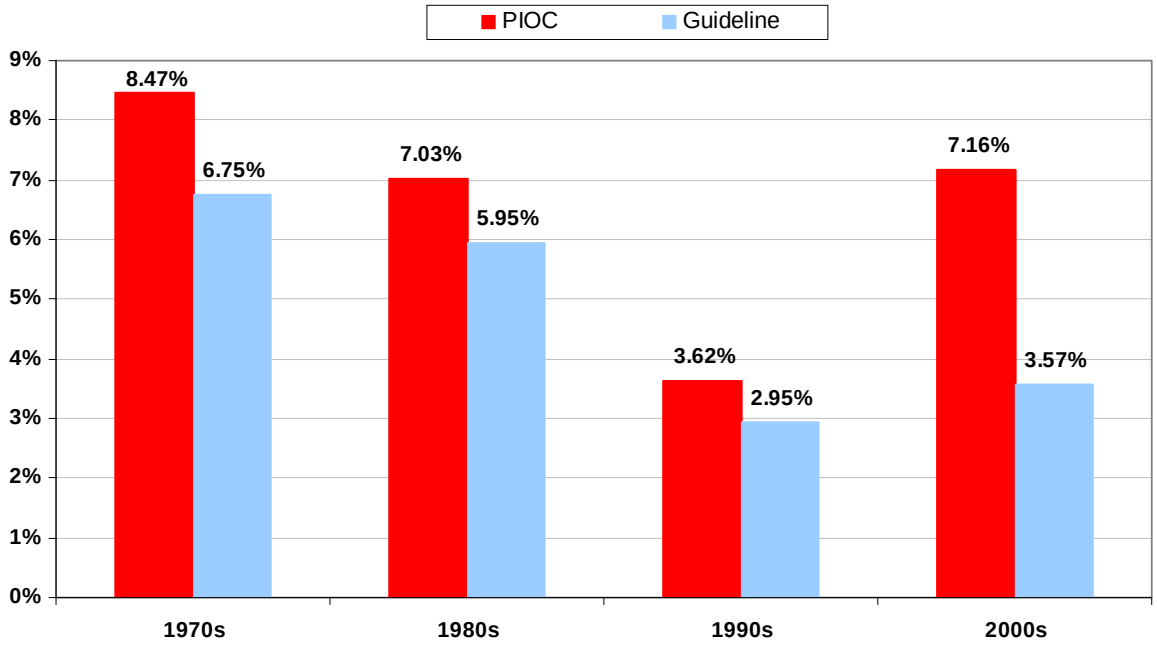
Each year brings new costs to buildings owners. This year the RGB heard testimony about increased enforcement of sanitation violations. Such burdens, in terms of time and money, fall heaviest upon the small rental properties, the backbone of the City's affordable housing stock.

Rent Guidelines Have Not Kept Pace with Increased Building Operating Costs

While building operating costs have been soaring at historically high rates, rent increases granted by the RGB have fallen far behind. In recent years, the one-year rent guideline increase has amounted to only half of the increase in building operating costs. Specifically, the average increase in the one-year guideline since 2000 has been 3.57% compared to a 7.16% annual increase in the PIOC (*see chart below*).

Recent Guidelines Have Not Kept Pace With Operating Cost Increases

Average Annual Increase: PIOC and One-Year Rent Guideline



Source: NYC Rent Guidelines Board Reports 1970-2007.

In other words, since 2000, building operating costs have increased by more than 50% while property owners have, at best, collected increases of 25% based on the one-year rent guideline increase.

Not only have recent guidelines been low relative to the PIOC, they have also been low in absolute terms compared to prior levels of rent adjustment. The only period in which rent guideline have been lower than in recent years (since 2000) was in the period of the 1990's when inflation was at very low levels in terms of the CPI as well as the PIOC.

The recent pattern of rent increase adjustments also sharply contrasts with the historic norm in which the one-year guideline has equaled more than 80% of the PIO. As shown in the table below, prior to 2000, through periods of high inflation and low inflation, the one-year guideline has consistently provided rate increases equal to at least 80% of the PIOC. Only recently have levels of rent adjustment fallen below their historic norms.

Recent Guidelines Are At Historic Lows

One-Year Guideline as a Percent of PIOC	
1970 - 1979	80%
1980 - 1989	85%
1990 - 1999	84%
2000 - 2006	50%

Source: NYC Rent Guidelines Reports 1970-2006

Low Rent Guidelines Have Resulted in Deteriorating Rental Housing Economics

In the context of the unusual buoyancy of the New York City real estate sales market it may seem unusual that the economics of rent regulated housing are sinking rather rising. But it should come as no surprise that there has been a steady deterioration of rental housing economics as recent rent increases have simply failed to keep pace with increased operating costs.

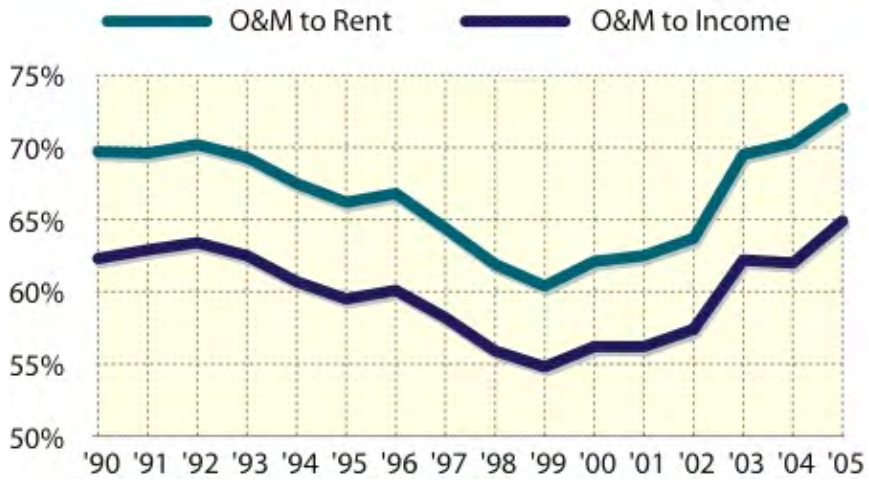
Each year, the RGB staff provides a number of indicators of the health of the City's rent regulated housing based on income and expense statement filed by owners with the City's Department of Finance. From 1989, when such data was first available, until 1999 these indicators showed a gradual improvement in building economics. Beginning in 2000, however, these indicators began to trend downward. Based on the most recent report, which includes economic data from 2005, all indicators show that regulated housing is in its worst position since 1989.

Take building operating ratios as an example. Operating ratios are expressed as a percentage of building income or rent consumed by the operating costs measured by the Price Index. Obviously, the lower the ratio, the better because lower ratios mean there is more revenue available for profit, to finance a mortgage and to pay for building improvement.

As can be seen in the Chart below, building operating ratios generally declined from 1989 through 1999. Beginning in 2000 these ratios began to rise. According to the most recent income and expense data produced by the RGB staff, operating ratios in 2005 were at their highest level since such data was first collected.

Operating Ratios At Historic Highs

Ratios of Citywide Average Monthly Audited O&M Costs to Average Monthly Gross Income and Rent 1990-2005



Source: NYC Rent Guidelines Board 2007 Income & Expense Report

Other economic indicators tell the same story. Net operating income (NOI) is the dollar amount left over to cover debt service, capital improvement costs and profit after paying for operating costs. Inflation-adjusted NOI, as calculated by RGB staff, fell in the early 1990's and then generally grew until 2000 when it leveled off and then began to decline. According to the most recent RGB Income and Expense Report, inflation-adjusted net operating income was *down* 12.3% for the period 1989 to 1995.

The absolute dollar value of net operating income is critical to sustaining affordable housing. While net operating income in core Manhattan averages $447 per month per apartment, NOI in the Bronx averages only $195 per month per month. Such a small amount of net operating income, especially in smaller buildings, makes it extremely difficult to finance debt for improvements or pay for extraordinary repair costs when they occur.

The recent deterioration of regulated housing economics has coincided with and is directly related to the relatively low rent guidelines enacted since 2000.

It should be noted that the deteriorating condition of rent stabilized housing in recent years has occurred despite the availability of revenue, in addition to rent guideline increases, as a result of a State-mandated vacancy allowance of 20% and the ability to achieve de-regulation or market rents in certain circumstances. This indicates that the additional sources of income are insufficient to offset the losses imposed by the inadequate rent guideline increases of recent years.

Despite the obvious evidence of economic distress in the regulated housing sector, some have pointed to the high sales prices recently achieved for regulated properties as an indication that these regulated properties must be profitable. This is incorrect, for two reasons.

First, investors who are paying high prices for regulated properties may have unrealistic expectations and may not be able to realize either the increased rent revenue or the operating cost savings they expect. They may pursue all available means to achieve market rents or they may have simply made a bad investment.

Second, while some owners with financial difficulties may have been driven to sell their properties, the majority of long-term owners who must meet today's operating costs with today's rental income derive no benefit from high sales prices.

Higher Guidelines and Supplemental Increases Are Needed to Sustain Affordable Rental Housing

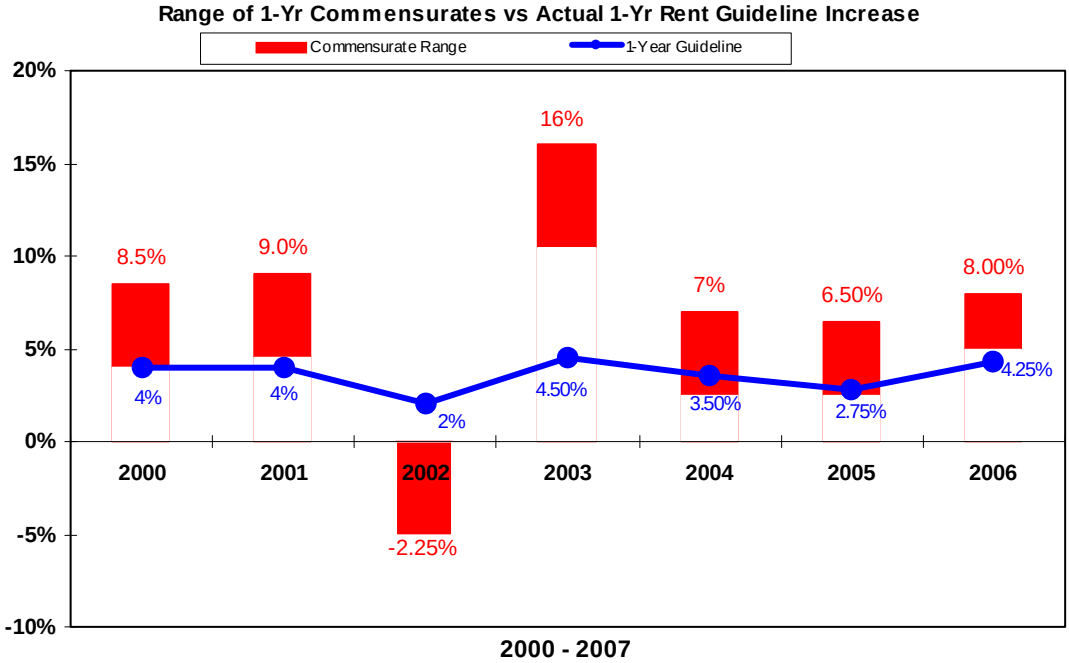
Another way to view the adequacy of recent rent guidelines is in relation to the range of commensurate rent adjustments provided each year by the RGB staff. The commensurate rent adjustment formulas indicate the level of rent guidelines needed to keep owners whole in the face of rising costs reflected in the Price Index. The commensurate adjustment formulas vary in their assumptions regarding whether or not net operating income is adjusted for inflation and whether or not the revenue from vacancy increases is factored into the formula.

In five of the last seven years, the one-year rent guideline has fallen below or at the very bottom of the range of possible commensurate rent adjustments (*see chart on next page*). In 2002, the 2% one-year guideline increase was actually above the commensurate range because the Price Index was zero. That "extra" increase was more than obliterated in the following year when the Price Index soared to nearly 17% and the one-year guideline was only 4.5%.

In other words, recent rent guideline increases have not even come close to providing property owners with the revenue they need to meet increased operating costs.

This year, the commensurate rent adjustments based on the Price Index increase of 5.1% range from 3.25% to 5.75% for a one-year lease and from 5.75% to 9.75% for a two-year lease.

Rent Guidelines Have Fallen Below Required Revenue Targets



Source: NYC Rent Guidelines Board, Price Index Repoprts 2000-2006.

We have argued in this Submission that recent rent guidelines at the low end or below the commensurate rent adjustments have resulted in the economic deterioration of regulated housing, despite the availability of revenue from additional sources.

Even if this year's guidelines are at the top end of the Preliminary Guideline range (2% to 4.5% for a one-year lease and 4% to 7.5% for a two-year lease), the guidelines will not come close to the revenue target required to meeting last year's 5.1% increase in operating costs.

This year, we urge the RGB to enact rent guidelines at the high end of the commensurate range. Certainly, the one-year rent guideline should at least be equal to the 5.1% increase in operating costs measured over the prior year.

Higher guidelines are justified not only by the current Price Index, but also to compensate for the inadequacy of recent guidelines and to moderate the need for higher guidelines next year when operating costs are expected to increase

even more.

In addition, we urge the RGB to provide a supplemental adjustment for low-rent apartments. Low-rent adjustments were a common feature of rent guidelines for many years. Such supplemental adjustments are justified by the fact that a percentage increase applied to a low-rent apartment yields less revenue than the same percentage applied to a high-rent apartment.

It is also the case that low-rent stabilized apartment result from long-term occupancy. As shown in the Table below, there is a direct relationship between rent level and length of occupancy. Apartments continuously occupied since 1990 or earlier have a median rent of $666 compared to a median rent of $973 for more recent movers.

Long-term Tenants Have Bargain Rents and Low Rent to Income Ratios

Stabilized by Year Moved, excludes Low Income				
Year Moved into Unit	**Median Income**	**Median Out of Pocket Rent**	**Median Out of Pocket Rent as a Percentage of Income**	**Total Units**
Prior to 1990	$40,000	$666	20.7%	170,091
1990-2001	$45,000	$810	21.2%	304,596
2002 or after	$46,900	$973	25.1%	257,931
Total	**$45,000**	**$840**	**22.3%**	**732,618**

Source: Quantitative Analysis, Inc., NYC Housing & Vacancy Survey 2005.

In addition, even though long-term tenants have incomes somewhat lower than the median income, their rent burdens are still very affordable, with a median out-of-pocket rent-to-income ratio of just 20.7% compared to overall median of 22.3%.

Because low rents tend to be concentrated in certain neighborhoods and buildings, the low rent increase percentages of recent years have simply not yielded enough revenue to help owners, especially small property owners, meet increased operating costs.

And because average apartment operating costs have increased in recent years, we suggest that there be a $25 supplemental adjustment for any apartment renting for $600 or less per month, in addition to any guideline increase.

The RGB Cannot Be Swayed by Other Income Sources or Affordability Concerns When Determining Necessary Rent Increases

Despite what appears to be a clear case for substantially higher renewal guidelines increases this year, a number of RGB members have suggested that there may be factors which mitigate the need for such increases.

The availability of substantial rent increases available upon vacancy is considered as a potentially mitigating factor.. However, the economic deterioration of regulated housing since 2000 has occurred despite the availability of such increases.

The economic data upon which the RGB relies, derived from income and expense filings by property owners, includes all sources of building income including increased income available from vacancies as well as commercial and non-rental income. Yet, this inclusive economic data demonstrates that income from sources other than rent guideline increases has not been sufficient to offset the negative effect of inadequate rent guideline increases.

It must also be noted that the availability of vacancy increases varies geographically. For instance, the RGB was presented with evidence that 84% of deregulated apartments occur in core Manhattan. Clearly, the economic benefits of deregulation do not benefit affordable housing outside Manhattan.

The RGB was also presented with evidence that the average rent increase upon vacancy city-wide was 9.8%, not the 20% increase available by State law. It can safely be assumed that the average vacancy increase masks the fact that vacancy increases in core Manhattan may be 20% or higher, but that vacancy increases outside Manhattan may be less than 9.8% average.

Some RGB members have also suggested that higher guidelines may not be collectible because of the presence of preferential rents, which tend to reflect the average rent in a specific neighborhood. First, it should be noted that preferential rents comprise only a small portion of all stabilized apartments. Data provided by RGB staff demonstrates that only 15% of stabilized apartments have preferential rents.

It should be understood that preferential rents can be increased when warranted as operating costs rise. Preferential rents may, since 2003, be raised to the legal regulated rent upon renewal, though many preferential rents are locked in by lease terms and are increased in tandem with the legal rent.

However, the existence of a small number of preferential and market rents does not mean that these rents cannot, are not and should not be increased.

Finally, many RGB members routinely cite the need to balance the need for increased rents against the ability of stabilized tenants to pay those rents. Even if there was a wide-spread crisis of housing affordability in New York City, the RGB must primarily weigh the ability of property owners to maintain their building in habitable condition against the rent increases needed to maintain habitable buildings.

The fact of the matter is that most rent stabilized housing provides bargain rents for households who can well afford their rents as well as required rent increases. As we can see in the Chart below, low-income households have a substantial rent burden. But these poverty level households can barely afford any rent without government assistance. It is certainly not the purpose of the rent stabilization system or the RGB to assume the role of a government income assistance program.

Typical Household Have Low Rent Burdens

	Median Income	Median Out of Pocket Rent	Median Out of Pocket Rent as a Percentage of Income	Total Units
Low Income *	$9,778	$579	57.4%	266,694
All Other	$45,000	$840	22.3%	732,618
Total	$34,000	$768	25.7%	999,312

**Low Income is defined as the 27% of stabilized households that have incomes lower than 125% of the 2004 Federal Poverty thresholds*

The majority of rent stabilized households, in contrast, have a median out-of-pocket rent-to-income ratio of only 22.3%, paying a median rent of only $865 per month. The rent burden for the typical stabilized renter is much lower than the median rent burden for renters nation-wide and can hardly be characterized as constituting an affordable housing crisis.

Conclusion

- The bottom-line of regulated rental housing is weakening even as the for-sale market is booming
- Deteriorating rental housing economics is the direct result of inadequate rent guideline increases
- Building operating costs are increasing at historic highs and are likely to continue rising
- Higher rent guidelines are needed this year to compensate for past losses and current cost increases
- Rent stabilized housing is the largest source of affordable housing
- New York City cannot afford to lose its affordable housing for lack of adequate renewal rent increases